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ENDING THE ECONOMIC WAR AMONG STATES

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ABSTRACT

The United States is under siege; however, the cause is not a foreign adversary. Rather, infighting among states to attract and retain big businesses is jeopardizing the Nation's economic prosperity.

States compete for businesses, using tax incentives, hoping to capitalize on the benefits these businesses represent. Benefits include improved job growth numbers, a future increase in tax revenue, or, simply, elevated political clout. While competition can lead to a more efficient use of resources, unregulated competition between states for businesses does not illustrate this theory. A national auction for a business, where states are blind to rival offers, may, and arguably does, lead to states offering inflated tax incentives—tax incentives that discriminate against interstate commerce.

Nonetheless, the Constitution appears to provide a path forward. As seen through dormant Commerce Clause jurisprudence, the Constitution makes it unlawful for states to implement tax incentives that discriminate against interstate commerce. But the current case-by-case approach of litigating the legality of state-level tax incentives suffers from various inefficiencies. This Note offers an alternative solution.

This Note will argue that ending the economic war among states, caused by the imprudent distribution of state-level tax incentives, requires Congress to promulgate legislation modeled after the European Union's State Aid Control Treaty.

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I. INTRODUCTION

One problem plagued the United States in its infancy to such an extent that it has been argued as the main reason for the adoption of the Constitution.[1] This problem was the "conflict of commercial regulations, destructive to the harmony of the [s]tates," created by the inability of the federal government to regulate commercial intercourse among the states.[2] Under the Articles of Confederation,[3] each state was free to adopt "measures fostering its own local interests without regard to possible prejudice to nonresidents."[4] As one Supreme Court Justice asserted, "[i]f there was any one object riding over every other in the adoption of the constitution, it was to keep the commercial intercourse among the [s]tates free from all invidious and partial restraints."[5]

This sentiment of fostering state cooperation was not only the central issue on the minds of the drafters of the Constitution but remains endorsed as an issue of central importance by the Supreme Court to this day.[6] While the Nation has consistently

[1] Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 281 (1824) (Johnson, J., concurring).

[2] *Id.*

[3] ARTICLES OF CONFEDERATION of 1781.

[4] Camps Newfound/Owatonna v. Town of Harrison, 520 U.S. 564, 571 (1997).

[5] *Ogden*, 22 U.S. (9 Wheat.) at 231.

[6] *Camps Newfound/Owatonna*, 520 U.S. at 571–72 (citing H.P Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 534–35).

attempted to achieve cooperation between states since its founding, destructive rivalries between states persist.

Take, for example, Amazon's widely publicized search for the home of its second corporate headquarters (HQ2) from 2017–2018.[7] After Amazon announced an interest in finding a home for its HQ2, the company received bids, which included tax incentives and subsidies, from states across the Nation.[8] Over a thirteen-month period, Amazon solicited these bids while bartering with the prize of bringing a state "50,000 employees and the glory of housing an international tech giant."[9] How were states supposed to win this prize? By offering more generous incentives than competing states and by flaunting the amenities of their state in a more convincing manner than their counterparts?[10] At least one would think that would be the answer. However, Amazon's decision did not appear to rest on the merits of the state or city bids. Instead, Amazon chose to split its headquarters in a predictive manner between Washington, D.C. and Queens, New York.[11] As one commentator put it:

> Did the word's smartest company really need 13 months, and applications from 238 cities, to reach the striking conclusion that it should invest in New York and D.C.? The former is America's heart of capital, and the latter is America's literal capital, where Jeff Bezos, chief executive of Amazon, already owns a house and a newspaper.[12]

While there is no definite answer, a plausible conclusion is that this "national auction" was nothing more than an exercise to pit states and cities against each other in a bidding war to raise the magnitude of the incentives offered by Amazon's shortlist of locations on which the company had already decided. If this was the case, Amazon certainly succeeded by securing multiple billion dollars' worth of incentive money for their HQ2.[13]

Deals such as Amazon's are not unique. Between 2008 and 2018, incentive packages totaling more than $1 billion have been rewarded to "Boeing, Nike, Intel, Royal Dutch Shell, Tesla, Nissan, Ford and General Motors . . . to either move their headquarters within the U.S. or, quite often to keep their headquarters right where they

[7] Derek Thompson, *Amazon's HQ2 Spectacle isn't Just Shameful—it Should be Illegal*, THE ATLANTIC (Nov. 12, 2018, 10:10 AM), https://www.theatlantic.com/ideas/archive/2018/11/amazons-hq2-spectacle-should-be-illegal/575539/.

[8] Allison Griswold, *A Nearly Complete List of the 238 Places that Bid for Amazon's Next Headquarters*, QUARTZ (Nov. 4, 2017), https://qz.com/1119945/a-nearly-complete-list-of-the-238-places-that-bid-for-amazons-next-headquarters/.

[9] Thompson, *supra* note 7.

[10] Nathan M. Jensen, *Five Economic Development Takeaways from the Amazon HQ2 Bids*, BROOKINGS INST. (Mar. 4, 2019), https://www.brookings.edu/research/five-economic-development-takeaways-from-the-amazon-hq2-bids/.

[11] Thompson, *supra* note 7.

[12] *Id.*

[13] Jensen, *supra* note 10.

are."[14] This competition where states fight over businesses with tax incentives and subsidies has been described as "the second civil war."[15] This description is a stark contrast to the Constitution's goal of ending "conflict of commercial regulations, destructive to the harmony of the [s]tates."[16]

However, this issue is not just a concern for states and cities pressured into extending these offers, but also for individual taxpayers whose money is used to finance these incentive packages;[17] incentive packages that have been described by an economist at George Washington University as having "no discernible impact on firm expansion, measured by job creation."[18]

While some tax incentives appear simply to be a product of economic protectionism, not all incentives are a product of such disingenuous motivations. As succinctly put by Greg Leroy from Good Jobs First, "an incentive is [for] something that should happen but isn't happening."[19] Thus, this Note is not an argument against state-level tax incentives in general. Rather, this Note argues for Congress to adopt legislation that allows for worthy policy objectives, such as revitalizing economically depressed areas or providing aid to research and development initiatives, to be achieved through targeted incentives while simultaneously bringing an end to tax incentives that unlawfully discriminate against interstate commerce. This Note argues that given the limits of the dormant Commerce Clause in effectuating change through litigation, ending the economic war among states requires the theory underlying the dormant Commerce Clause to be promulgated into federal legislation modeled after the European Union's (EU) "State Aid Control Treaty."

In Part II, this Note introduces the type of economic development incentives that states wield against each other and then establishes how these weapons are used in the ongoing economic war between these states. Part III of this Note analyzes the dormant Commerce Clause and the jurisprudence surrounding the doctrine, then highlights the shortcomings of using this doctrine on a case-by-case basis in bringing an end to the economic war between states. Part IV of this Note introduces the European Union's State Aid Control Treaty and then describes why Congress must enact federal legislation modeled after the European Union's treaty to bring an end to the economic war among states. Part V proposes federal legislation modeled after the European

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[14] Thompson, *supra* note 7.

[15] Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 385–86 (1996).

[16] Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 281 (1824) (Johnson, J., concurring).

[17] Thompson, *supra* note 7.

[18] Nathan M. Jensen, *Job Creation and Firm-Specific Location Incentives*, (Geo. Wash. Univ., Working Paper), http://www.natemjensen.com/wp-content/uploads/2014/09/Kansas-Working-Paper-7-23-15.pdf; *see also* Emily Badger, *Should We Ban States and Cities from Offering Big Tax Breaks for jobs?*, WASH. POST (Sept. 15, 2014), https://www.washingtonpost.com/news/wonk/wp/2014/09/15/should-we-ban-states-and-cities-from-offering-big-tax-breaks-for-jobs/.

[19] Badger, *supra* note 18.

Union's State Aid Control Treaty and establishes Congress' power to enact this legislation. Part VI summarizes the assertions of the Note.

II. THE ECONOMIC WAR AMONG STATES AND THE WEAPONS OF THE WAR

In Part II.A of this Note, the arsenal of economic development incentive tools used by states to compete for business is revealed. Then in Part II.B, the counterintuitive result of all states losing in this competition for businesses is explained.

A. The Weapons – Economic Development Incentives

Economic development incentives, the figurative weapons of the economic war among states, come in an array of forms and from an array of sources.[20] However, economic development incentives commonly come from state governments, thus state-level incentives will be the focus of this Note.[21] Joseph Parilla and Sifan Liu of the Brookings Institution define economic development incentives as "direct financial benefits provided to firms to incentivize their opening, expansion, or retention."[22] Parilla and Liu note that economic development incentives are distinguished from broader economic development efforts because the former are provided on a selective basis to individual businesses.[23] Others have defined economic development incentives as "cash or near-cash assistance provided on a discretionary basis to attract or retain business operations owned by large businesses."[24] Moreover, opponents of economic development incentives refer to theses specific incentives as "corporate welfare" and define this welfare as government assistance offered to a business or industry that is not offered to others.[25] Estimates for the value of local and state economic development incentives range from $45 billion to $90 billion dollars annually.[26]

Economic development incentives come in many different forms. These forms include but are not limited to investment tax credits, tax abatements, infrastructure improvements and real estate rent reductions, industrial bonds, and worker training incentives.[27] The focus of this Note will be state-level tax incentives, which are

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[20] Joseph Parilla & Sifan Liu, *Examining the Local Value of Economic Development Incentives*, BROOKINGS INST. (March 2018), https://www.brookings.edu/wp-content/uploads/2018/02/report_examining-the-local-value-of-economic-development-incentives_brookings-metro_march-2018.pdf.

[21] *Id.*

[22] *Id.*

[23] *Id.*

[24] Timothy J. Bartik, *Solving the Problems of Economic Development Incentives*, *in* REIGNING IN THE COMPETITION OF CAPITAL 103, 104 (Ann Markusen, ed. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 2007).

[25] Donald L. Barlett & James B. Steele, *Special Report: First in a Series: Corporate Welfare,* TIME, Nov. 9, 1998, at 38.

[26] Parilla & Liu, *supra* note 20.

[27] Enrich, *supra* note 15.

implemented through tax modifications for specific businesses. As previously mentioned, incentives have the ability to be used for productive purposes, such as uplifting an economically depressed community or expanding job opportunities. However, these same incentives can be used by states to masquerade economic protectionism behind the cloak of a seemingly innocent business assistance program.[28] The difficult task of determining the true motive and effect of such incentives is hindered by the complexities of litigation; thus, as will be seen in Part V of this Note, federal legislation is needed. Without such legislation, states will continue to engage in a destructive economic war.

B. The War – The Battle for Businesses

When states seek to attract or retain a business, there is often a negotiation process that leads to businesses obtaining incentive packages from these states.[29] There is not a standardized process for determining the magnitude of business retention or attraction incentives offered by states; thus, states compete in a guessing game of attempting to outbid competing states without the knowledge of the substance of the competing deals.[30] This is a classic case of the prisoner's dilemma and it can lead states to unnecessarily offer overly generous deals to businesses.[31] While Congress could explore drafting legislation to remedy the issue of the prisoner's dilemma by creating legislation that limits the scope of the deals offered to businesses or through legislation that makes states publish the details of these deals so all parties compete with equal information, this issue is not explored by this Note. Rather, this Note focuses on the inevitable end result of economic development tax negotiations—some businesses obtaining deals that their competitors cannot. The effect of these deals can lead to unfair competition and actions contrary to achieving harmony among states.[32]

As noted, the economic development incentive bidding process pits states against each other, but determining the winners and losers is not a straightforward calculation.

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[28] Badger, *supra* note 18.

[29] Matthew Schaefer, *State Investment Attraction Subsidy Wars Resulting from a Prisoner's Dilemma: The Inadequacy of State Constitutional Solutions and the Appropriateness of a Federal Legislative Response*, 28 N.M. L. REV. 303, 303 (1998).

[30] *Id.*

[31] *Id.* at 311. Schaefer described the prisoner's dilemma as:

> Two prisoners are separately interrogated by the authorities, who attempt to extract confessions from each implicating the other. If both are silent, each will go free. If both confess, each will get a moderate sentence. If one confesses and the other does not, the former will get a light sentence and the latter a heavy sentence. Accordingly, both prisoners would be best off it each remains silent, but each fears the other will confess. To avoid the danger of the heavy sentence that would follow from the other's confession, each confesses and incurs a moderate sentence. The prisoners are unable to reach their preferred outcome (total silence) because they are unable to communicate and reach a binding agreement.

Id.

[32] Jensen, *supra* note 10, at 2.

While locations that win this bidding war, such as New York and Washington, D.C. in the case of Amazon, may claim victory, the computation is not that simple.[33] It could be argued that there are no winners in this economic battle other than the business who exploits the warfare between states to obtain inflated tax incentive offers. By taking on incentive bids from across the country, the value of these offers is artificially inflated above their efficient levels.[34] For example, New York and Washington, D.C. may have been able to attract Amazon with a lesser magnitude of incentives than what their final offer represented, but because the bidding was not transparent, these locations likely offered incentives at an unnecessarily high level in an attempt to outcompete other states.[35] The mechanics of this conundrum is described below.

Economic theory would suggest that the most efficient use of resources is achieved when the entity who values a resource the most obtains it.[36] Transferring this theory to economic development incentives, it would seem to follow that the optimal place for Amazon to land its headquarters would be in the places demanding Amazon the most, as represented by the magnitude of these place's bids. States rely on this intuitive theory and fight for businesses with tax incentive offers. However, it is not a secret that basic academic theory does not always transfer seamlessly to the real world.[37] Amazon seemingly predetermined the locations of its HQ2 before even taking on bids and used the bidding process simply to sweeten the pot.[38]

The fact of the matter is states are fooled into thinking that they are competing to win a business over.[39] These states then expend their scarce resources by offering incentives.[40] However, these offers are nothing more than additional air pumping up the magnitude of the incentives from the already decided upon state or shortlist of states. Thus, in this war among states, a state either loses by missing out on the political victory of securing a business, or a state loses when they achieve the political win by winning a business over but must expend more resources than is necessary. The only

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33 Thompson, *supra* note 7.

34 *Id.*

35 *Id.*

36 Roy Cordato, *Free Markets and Highest Valued Use*, FOUND. FOR ECON. EDUC. (May 1, 2000), https://fee.org/articles/free-markets-and-highest-valued-use/#:~:text=The%20argument%20behind%20what%20I,whose%20bid%20is%20the%20highest.

37 *Id.* (stating that the "highest valued use" theory relies on assumptions that cannot be logically sustained).

38 Thompson, *supra* note 7.

39 *Id.*

40 *See* Michael J. Boyle, *Scarcity*, INVESTOPEDIA (Jan. 16, 2021), https://www.investopedia.com/terms/s/scarcity.asp; NATIONAL ASSOCIATION OF STATE BUDGET OFFICES, 2020 STATE EXPENDITURE REPORT 8 (2020).

winner appears to be the business who picks a location and then is rewarded with inflated incentives from the state caught in the trap of the prisoner's dilemma.[41]

The scenario described above illustrates a field of defeated states gunned down by the firepower of their neighbors and a sole winner, the business, standing in triumph on top of these exploited states. Such an illustration is not one that was envisioned when the Constitution was enacted to achieve unity among the states.[42] Making matter worse, as was seen above in Part II.A, these trounced states have no shortage of economic development incentives in their arsenal to fire at each other.[43] But the United States is not helpless in bringing an end to this destructive combat; the theory underlying the dormant Commerce Clause provides a solution.

III. THE DORMANT COMMERCE CLAUSE AND ITS LIMITATIONS

In Part III.A, the dormant Commerce Clause is presented. This legal doctrine prohibits conduct by states that discriminates against interstate commerce, and it is asserted by this Note as the theory on which Congress should enact the proposed legislation to bring an end to the economic war among states. In Part III, Subpart B, major Supreme Court decisions regarding state-level tax incentives are introduced, and their holdings, which rely on the dormant Commerce Clause, are explained. Part III.B closes by synthesizing these precedents to conclude that state tax incentives are unconstitutional if they discriminate against interstate commerce by unduly favoring a business in order to attract it within the state's borders, or if these tax incentives are used to entice a business to stay. In Part III, Subpart C, the shortcomings of the Supreme Court's jurisprudence around state tax incentives are explained by highlighting the failings of relying on a case-by-case system. This Part concludes by arguing that, given barriers to litigation and the actions of opportunistic states, the case-by-case system must be replaced by legislation to truly effectuate the Supreme Court's dormant Commerce Clause jurisprudence.

A. The Doctrine

Through the jurisprudence of the Supreme Court, the Commerce Clause has been interpreted not only to give Congress the "positive" power to regulate interstate commerce, but it has also been interpreted by the Court as a "negative" restraint on state action.[44] This negative interpretation, known as the dormant Commerce Clause,

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41 Thompson, *supra* note 7; *see also* Schaefer, *supra* note 29 (describing the prisoner's dilemma).

42 Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 231 (1824) (Johnson, J., concurring).

43 Enrich, *supra* note 15.

44 *See* Fort Gratiot Sanitary Landfill v. Michigan Dep't of Nat. Res., 504 U.S. 353, 359 (1992); *see also* Quill Corp. v. North Dakota, 504 U.S. 298, 309 (1992); Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458 (1959); H.P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 534–35 (1949). This Note, though focusing on the dormant Commerce Clause, will use the terms "dormant Commerce Clause" and "Commerce Clause" somewhat interchangeably throughout. This is in line with Supreme Court cases that have done the same in treating dormant Commerce Clause violations as violative of the Commerce Clause itself. *See, e.g.*, Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 319 (1977) ("No State,

forbids states from interfering with interstate commerce or unduly burdening interstate commerce in the absence of legislation, and the doctrine acts as a limit on state power.[45]

The dormant Commerce Clause prohibits states from "advancing their own commercial interests by curtailing the movement of articles of commerce, either into or out of the state."[46] Moreover, the Court has opined that conduct by states that clearly discriminates against interstate commerce is unconstitutional "unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism."[47] The dormant Commerce Clause has been justified by the Supreme Court as necessary to further "the Commerce Clause's purpose of preventing a State from retreating into economic isolation or jeopardizing the welfare of the Nation as a whole."[48]

Depending on the action taken by a state, the Supreme Court applies different tests to determine whether the law is constitutional under the dormant Commerce Clause.[49] However, the Court's analysis always starts with a threshold question: Does the state law discriminate against interstate commerce?[50] A discriminatory law is one that treats out-of-state actors, or commodities, different than in-state actors, or commodities.[51] Furthermore, under a dormant Commerce Clause analysis, it has been found that the fact that in-state actors are subject to the same discrimination as out-of-state actors is immaterial for finding a law discriminatory.[52] Thus, even though state-level tax incentives may discriminate against one in-state actor over another in-state actor, this fact does not prohibit a tax incentive from being found discriminatory.[53]

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consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce . . . .'").

45 *See, e.g.*, Hughes v. Oklahoma, 441 U.S. 322, 326 (1979); Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 329 (1977).

46 *H.P. Hood & Sons, Inc.*, 336 U.S. at 535.

47 New Energy Co. v. Limbach, 486 U.S. 269, 274 (1988).

48 Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 180 (1995).

49 South Carolina State Highway Dep't v. Barnwell, 303 U.S. 177, 191 (1938).

50 *Barnwell*, 303 U.S. at 190; *see also* City of Philadelphia v. New Jersey, 437 U.S. 617, 623 (1978).

51 *City of Philadelphia*, 437 U.S. at 626–27.

52 Dean Milk Co. v. City of Madison, Wis., 340 U.S. 349, 354 n.4 (stating that it is immaterial that in-state actors are subject to similar constraints as out of state actors when determining whether a law is discriminatory).

53 *City of Philadelphia*, 437 U.S. at 628.

But, not all discriminatory laws are the same; there are facially discriminatory laws and laws that are facially neutral but discriminatory in effect.[54] Nonetheless, it is important to note that no matter the type of discriminatory law, these discriminatory actions do not carry any presumption of constitutionality and no deference to the state legislator is given.[55] If a state law is found to be discriminatory then the court applies a strict scrutiny analysis to determine whether a law is constitutional.[56]

The strict scrutiny analysis can be broken down into three steps.[57] The first step is to determine what the state's interest is in enacting the discriminatory law, the second step is to determine if the law is effective in furthering the state's interest, and the third step is to consider if there are nondiscriminatory alternatives available in achieving the state's goal.[58] For a law to pass this test it must be effective in achieving a legitimate state interest, such as protecting the environment of the state, and there must not be a nondiscriminatory alternative available to achieve that interest.[59] If there is not a legitimate state interest being furthered by the action or there is a nondiscriminatory alternative available to achieve the same end, then the law is held to be unconstitutional.[60]

In the case of non-discriminatory laws—facially neutral laws that do not discriminate against interstate commerce—the law carries a presumption of constitutionality, and the Court applies what has become known as the Clover Balancing Test.[61]

Nonetheless, a targeted state-level tax incentive is inherently discriminatory because it is only offered to one in-state actor.[62] Thus, when analyzing the constitutionality of a state-level tax incentive, the court should apply the strict scrutiny test and give no deference to the motivations of those who offered the incentive. State-level tax incentives fall under the purview of the dormant Commerce Clause because

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[54] *See e.g.*, Hunt v. Washington State Apple Advertising Com'n, 432 U.S. 333, 352–53 (1977) (serving as an example of a facially neutral yet discriminatory in effect law); *City of Philadelphia*, 437 U.S. at 626–27 (serving as an example of facially discriminatory law).

[55] *See Hunt*, 432 U.S. at 353.

[56] Maine v. Taylor, 477 U.S. 131, 138 (1986) (applying the strict scrutiny test to a facially discriminatory law); *see also Dean Milk Co.*, 340 U.S. at 353 (applying the strict scrutiny test to a facially neutral but discriminatory in effect law).

[57] *Dean Milk Co.*, 340 U.S. at 353–56.

[58] *Id.*

[59] *Taylor*, 477 U.S. at 148 (stating that protecting a state's environment is a legitimate state interest).

[60] *Dean Milk Co.*, 340 U.S. at 355–56 (holding that a law was unconstitutional because a non-discriminatory alternative was available).

[61] Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 471 (1981). This test considers whether the burdens on interstate commerce from the law are clearly excessive in relation to the local benefit the law presumes to create. Here, the court is supposed to act in a deferential manner to the state legislator.

[62] Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 273 (1984).

their discriminatory effect may jeopardize the welfare of the Nation as a whole; this occurs when state-level tax incentives improperly favor an in-state business with excessive tax incentives not offered to out-of-state businesses and no legitimate purpose to support such distribution is offered.[63] Thus, the theory underlying the dormant Commerce Clause, removed from the constraints of litigation, will be used as the specific rationalization of this Note for enacting the proposed legislation to prevent the use of state-level tax incentives from improperly hindering economic activity between states. This theory can be further understood by looking at jurisprudence of the Supreme Court.

B. Case Law Applying the Doctrine to Tax Incentives

The Supreme Court has an extensive history of ruling on state tax incentives. In what could be argued as the most important case in this arena, *Boston Stock Exchange v. State Tax Commission*, the Court ruled on whether a tax imposed by the State of New York on securities transactions designed to assist the New York Stock Exchange was a valid assertion of the State's powers.[64] The consequence of the tax was that out-of-state companies were taxed at a higher rate than in-state companies. With this fact in mind the Court held, "a state may no more use discriminatory taxes to assure that nonresidents direct their commerce to business within the State than to assure that residents trade only in intrastate commerce"[65] and that "[n]o state, consistent with the Commerce Clause may, 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.'"[66]

Subsequently, in *Westinghouse Electric Corp. v. Tully*, the Court considered the constitutionality of New York's grant of a franchise tax credit to certain income of Domestic International Sales Corporations (DISC's).[67] Relying on its holding in *Boston Stock Exchange*, the Court held the franchise tax credit violated the Commerce Clause and stated, "whether the discriminatory tax diverts new business into the State or merely prevents current business from being diverted elsewhere, it is still a discriminatory tax that 'forecloses tax-neutral decisions and . . . creates . . . an advantage' to firms operating in New York by placing 'a discriminatory burden on commerce to its sister States.'"[68] Thus, the Court held that forbidding a tax credit to out-of-state corporations had the same effect as imposing a higher tax on these out-of-state business, and therefore, the tax credit violated the Commerce Clause.[69]

Next, in *Bacchus Imports, Ltd. v. Dias*, the Court considered the constitutionality of an exemption to Hawaii's liquor tax for only locally produced pineapple wine and

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63 *See, e.g.*, West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 205–06 (1994); *Bacchus Imports*, 468 U.S. at 273; Westinghouse Elec. Corp. v. Tully, 466 U.S. 388, 402–03 (1984).

64 Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 319 (1977).

65 *Id.* at 334–35.

66 *Id.* at 329 (quoting Northwestern Cement Co. v. Minnesota, 358 U.S. 450, 458 (1959)).

67 *Westinghouse*, 466 U.S. at 390.

68 *Id.* at 406 (quoting *Boston Stock Exch.*, 429 U.S. at 331).

69 *Id.* at 407.

okolehao.[70] There, the Court held that the local tax exemption violated the Commerce Clause while establishing that if a tax was "made on the basis of either discriminatory purpose or discriminatory effect" then the tax may amount to economic protectionism.[71] Using this test, the Court found the tax exemption was "clearly discriminatory" because the tax exemption "only applies to locally produced beverages" while there is "competition between the locally produced exempt products and non-exempt products from outside the State."[72]

Successively, in *New Energy Co. v. Limbach*, the Court deliberated on the constitutionality of an Ohio tax credit against sales tax on fuel for each gallon of ethanol sold that was applied only to ethanol produced in Ohio.[73] The Court quashed this tax credit, holding that "state statutes that clearly discriminate against interstate commerce are routinely struck down unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism."[74] The Court reasoned that while the protection of the health of a state's citizens could be a valid factor unrelated to economic protectionism, in this case the connection between the health of Ohio citizens and the ethanol tax credit was "no more than implausible speculation" that would "not suffice to validate this plain discrimination against products of out-of-state manufactures."[75] However, the Court noted that a tax incentive would be allowed as long as it "advances a legitimate local purpose that could not be adequately served by reasonably nondiscriminatory alternatives."[76] This assertion suggests that blatantly discriminatory tax incentives may be permissible if they reasonably further a non-discriminatory purpose.[77]

The Court again heard a case regarding tax incentives in *Camps Newfound/Owatonna v. Town of Harrison*, in which a Maine statute distinguished between businesses that served interstate clientele and those that served intrastate clientele.[78] The effect of the statute was that summer camps were taxed at a higher rate if the camp was operated principally for non-residents of Maine. The Court held that while the camp's goods and services were consumed locally, interstate commerce was affected because the attendance of the students required transportation across state lines. The corporation's status as a nonprofit entity did not prevent the application of the Commerce Clause.[79] Thus, because the statute expressly distinguished between

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[70] Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 265 (1984).

[71] *Id.* at 270.

[72] *Id.* at 271.

[73] New Energy Co. v. Limbach, 486 U.S. 269, 274 (1988).

[74] *Id.*

[75] *Id.* at 280.

[76] *Id.* at 278.

[77] *Id.*

[78] Camps Newfound/Owatonna v. Town of Harrison, 520 U.S. 564, 575 (1997).

[79] *Id.* at 584.

entities that served principally intrastate clientele and those that served principally out-of-state clientele, the statute was facially invalid under the Commerce Clause.[80] *Camps Newfound* establishes that state laws discriminating against interstate commerce on their face are invalid per se, irrespective of whether they apply to non-profit or for-profit businesses.[81]

These holdings show that it is unconstitutional for states to discriminate against interstate commerce by unduly favoring a business with tax treatment in order to attract it within the states borders or using tax incentives to entice a business to stay. While these holdings appear to prevent discriminatory tax incentives by states, they are not foolproof, and states have discovered avenues to favor local businesses by straddling the line of constitutionality.

C. The Limitations of the Doctrine

Case law regarding the dormant Commerce Clause's application to state tax incentives is ineffective at preventing the use of discriminatory tax incentives for several reasons. These reasons include exceptions to the dormant Commerce Clause's anti-discrimination requirement that may be misinterpreted, and barriers to litigation that have become relevant due to the Court's case-by-case analysis of state tax incentives.

The first of these exceptions that allow states to meander their way around the dormant Commerce Clause's anti-discrimination provision is the market-participant exception. The market-participant exception applies when a state enters the market as a "participant" instead of a "regulator" of commerce.[82] The doctrine was formulated in *Hughes v. Alexandra Scrap Corp.*, where the Court held "nothing in the purposes animating the Commerce Clause prohibits a State, in the absence of congressional action, from participating in the market and exercising the right to favor its own citizens over others."[83] In *Alexandra Scrap*, the Court held that Maryland could "artificially enhance the value of certain abandoned . . . [automobiles]" by acting as a purchaser in the market with state funds to ensure the removal of these abandoned automobiles from Maryland's streets and junkyards.[84] Moreover, in a subsequent case, *Reeves v. Stake*, the Court held that the State of South Dakota could act as a seller of cement to aid the state's cement industry under the market-participant exception.[85] The market-participant exception applies only for state subsidies, not state tax incentives. The Supreme Court has never addressed the constitutionality of non-tax subsidies directly but held that "a pure subsidy funded out of general revenue

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80 *Id.* at 565.

81 *Id.* at 581.

82 Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 810 (1976).

83 *Id.*

84 *Id.* at 809–10, 815.

85 Reeves v. Stake, 447 U.S. 429, 440 (1980); *see also* Dep't Revenue v. Davis, 553 U.S. 328, 352 (2008) (holding that a discriminatory tax scheme on municipal bonds assessing a lower tax rate on in-state municipal bonds versus out-of-state municipal bonds was allowable under the market-participant exemption).

ordinarily imposes no burden on interstate commerce, but merely assists local businesses."[86]

However, given that tax exemptions and subsidies serve "similar ends" it is possible that states will seek to uphold tax incentives by transferring the market-participant exception from subsidies to tax incentives.[87] This argument was attempted by the State of Maine in *Camps Newfound/Owatonna*.[88] The Court rejected this argument stating that an "open-ended exemption for charitable and benevolent institutions is not analogous to the industry-specific state actions that [the Court] reviewed in *Alexandria Scrap* and *Reeves*."[89] However, it follows that states may nevertheless attempt this argument of using the market-participant exemption by styling a tax incentive to target a specific industry.[90] The Court addressed this concern stating "our cases do not sanction tax exemptions serving similar ends" as subsidies.[91] While it would be logical to assume states would take notice of this holding and treat it as controlling, it is evident that states continually attempt to challenge the Court's holdings by imposing discriminatory tax incentives.[92] Thus, case law on the subject has proved to be ineffective at deterring states from imposing discriminatory tax incentives by falsely relying on the market-participant exception.

The next barrier preventing Commerce Clause case law from being effective in regulating state tax incentives is the discrimination exception noted in *New Energy Co. v. Limbach*.[93] There, the Court held, "state statutes that clearly discriminate against interstate commerce are routinely struck down unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism."[94] The Court noted that a tax incentive would be allowed as long as it "advance[s] a legitimate local purpose that could not be adequately served by reasonably nondiscriminatory alternatives."[95] Or in other words, "what may appear to be a 'discriminatory' provision in the constitutionally prohibited sense—that is, a protectionist enactment—

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86 West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 214 (1994) (Rehnquist. C.J., dissenting).

87 Camps Newfound/Owatonna v. Town of Harrison, 520 U.S. 564, 589 (1997).

88 *Id.*

89 *Id.*

90 *See West Lynn Creamery, Inc.*, 512 U.S. at 187; New Energy Co. v. Limbach, 486 U.S. 269, 277 (1988); *Camps Newfound*, 520 U.S. at 589.

91 *Camps Newfound*, 520 U.S. at 589.

92 Westinghouse Elec. Corp. v. Tully, 466 U.S. 388, 403 (1984).

93 *New Energy Co.*, 486 U.S. at 274.

94 *Id.*

95 *Id.* at 278; *see, e.g.*, Maine v. Taylor, 477 U.S. 131, 138 (1986); Sporhase v. Nebraska, 458 U.S. 941, 958 (1982); Hughes v. Oklahoma, 441 U.S. 322, 336–37 (1979); Dean Milk Co. v. Madison, 340 U.S. 349, 354 (1951).

may on closer analysis not be so."[96] The Court went on to note that the standards for this justification are high, but even so, this does not prevent states from attempting to impose tax incentives that are discriminatory under the guise of a "legitimate local purpose" that is not genuine.[97] Thus, case law on the subject is ineffective at deterring states from imposing discriminatory tax incentives because states may falsely rely on the "legitimate local purpose" exception.[98]

Moreover, as a proliferation of the obstacles discussed above, dormant Commerce Clause case law is ineffective at preventing discriminatory tax incentives because of barriers to litigation. The holding in *Boston Stock Exchange*, that "no state, consistent with the Commerce Clause, may impose a tax which discriminates against interstate commerce by providing a direct commercial advantage to local business,"[99] did not become a controlling prohibition on discriminatory state tax incentives. Rather, challenges to state tax incentives must be deliberated on a case-by-case basis given the absence of congressional action and ambitious states challenging the Court's tax incentive holdings.

However, those individuals or entities that have the motivation to challenge discriminatory tax incentives face hurdles in bringing suits against states. These potential plaintiffs include individual taxpayers, injured businesses, and competing states. Individual taxpayers have both financial and legal barriers. It is not a question of whether litigation is expensive. The costs of litigation to an individual taxpayer may not be worthwhile when weighing the risks. This financial barrier prevents the bringing of possible successful suits, and this inefficiency is caused by the case-by-case analysis.

Furthermore, taxpayers face the legal barrier of proving standing to bring suits. In *DaimlerChrysler Corp. v. Cuno*, local taxpayers brought a suit against DaimlerChrysler Corp., and state and local officials, alleging that tax incentives offered to the automobile manufacture violated the Commerce Clause by depleting state and local treasuries to which they contributed.[100] The agreement in question allowed for DaimlerChrysler to expand its local assembly plant, purchase, and install new manufacturing equipment in return for the City of Toledo, Ohio to waive the property tax for the plant and for the State of Ohio to give the corporation a credit against the state's franchise tax.[101] At the district court level, the Court held that the taxpayer plaintiffs had standing under the "municipal taxpayer standing" rule.[102] However, the District Court found that neither the municipal property tax exemption

96 *New Energy Co.*, 486 U.S. at 278.

97 *Id.*

98 *See id.*

99 Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 329 (1977).

100 DaimlerChrysler Corp. v. Cuno, 547 U.S. 332, 343–44 (2006).

101 *Id.* at 338–39.

102 *DaimlerChrysler Corp.*, 547 U.S. at 339–40 (citing Massachusetts v. Mellon, 262 U.S. 447 (1923)).

nor the state franchise tax credit violated the Commerce Clause.[103] The case was appealed by the taxpayers to the Sixth Circuit, which agreed with the District Court regarding the municipal property tax exemption but held that the state franchise tax credit violated the Commerce Clause by discriminating against interstate commerce in "coercing businesses already subject to the Ohio franchise tax to expand locally rather than out of state."[104]

The Supreme Court granted certiorari to review whether the state franchise tax credit violated the Commerce Clause, and in doing so directed the parties to address the issue of standing under Article III of the U.S. Constitution.[105] The Court held that the Plaintiffs, state taxpayers, did not have standing under Article III to challenge state tax or spending decisions simply by their virtue as state and municipal taxpayers.[106] The Court opined that state taxpayers lacked standing because the alleged injuries were not "concrete and particularized" in that the injury depended on how legislators respond to the reduction in revenue.[107] Thus, the Court did not reach the merits of this case regarding the state franchise tax credit's implications on the Commerce Clause.

DaimlerChrysler illustrates the barrier that taxpayers face in bringing suits regarding the implications of tax incentives on the Commerce Clause.[108] Because state taxpayers face the burden of showing "concrete and particularized" injury to challenge a state tax incentive, cases of this type will not be brought as often as the merits of the case may require. Thus, the reliance on a case-by-case determination of whether a tax incentive violates the Commerce Clause is, again, shown to be inefficient.

Moreover, injured businesses that are discriminated against in interstate commerce will also face barriers in bringing suits that hold states accountable for violations of the Commerce Clause. Like individual taxpayers, businesses must weigh the financial risk of litigation when determining whether to bring a suit challenging a state tax credit rewarded to a competing business. This exemplifies another inefficiency of the reliance on a case-by-case system to determine whether a state tax incentive violates the Commerce Clause.

Finally, states face unique burdens in determining whether to challenge the use of a discriminatory tax credit used by other states. States seek to attract business into their jurisdiction to benefit from the jobs, human capital, and revenue provided by these entities.[109] As an initial matter, states may not challenge possibly discriminatory tax incentives because in doing so, they may limit themselves from the use of their own similar incentives, which state officials use to attract businesses and claim political victories. If a particular state is aware that other states are using tax credits to attract businesses, then that state will feel pressured to not limit its own arsenal of

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[103] *DaimlerChrysler Corp.*, 547 U.S. at 340.

[104] Cuno v. Daimler Chrysler, Inc., 386 F.3d 738, 743 (6th Cir. 2004).

[105] *DaimlerChrysler Corp.*, 547 U.S. at 340.

[106] *Id.* at 346.

[107] *Id.* at 344.

[108] *See id.*

[109] Schaefer, *supra* note 29, at 309.

development tools.[110] This demonstrates the "prisoner's dilemma" effect which leads to a sub-optimal use of resources.[111] In this context, the resource is meritorious litigation of discriminatory incentives, and because states may choose not to challenge discriminatory tax incentives based solely on a political rationale, a sub-optimal number of suits challenging discriminatory state tax incentives will result.[112] This, too, exemplifies another inefficiency of the reliance on a case-by-case system used to determine whether a state tax incentive violates the Commerce Clause.

The above illustrations exemplify the ineffectiveness of a case-by-case approach; thus, a different approach is necessary. By acknowledging the value of the theory underlying the dormant Commerce Clause but noting the limitations of the dormant Commerce Clause in effectuating change on a case-by-case basis, it is evident that ending the economic war among states requires federal legislation modeled after the European Union's State Aid Control Treaty.

IV. THE EU'S STATE AID CONTROL TREATY AND THE NEED FOR A DOMESTIC VERSION

In Part IV.A, the European Union's State Aid Control Treaty is introduced. This treaty acts as a general prohibition against state aid in the European Union to prevent the distortion of competition across the member states.[113] However, the treaty does allow for exceptions to this general-prohibition rule by providing an allowance of state aid that is deemed compatible with explicit policy goals of the EU. In Subpart B, this Note argues that the EU's State Aid Control Treaty should act as the framework for Congress to enact the proposed legislation of this Note. There is currently no federal regulation in place regarding state-level tax incentives; thus, states arguably abuse their use of these tools leading to destructive competition among states. This Note's proposed legislation seeks to bring an end to this injurious conundrum.

A. The Treaty

The European Union's State Aid Control Treaty, Article 107 of the Treaty on the Function of the European Union, was established by the European Union to impede member states from offering aid that unduly distorts competition across the EU.[114] Under the treaty, "State Aid" is defined as "an advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities."[115] For a subsidy to be classified as State Aid the support must contain the following features:

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110 *Id.* at 311.

111 *Id.* at 303.

112 *See id.*

113 Consolidated Version of the Treaty on the Functioning of the European Union art. 107, Feb. 7, 1992, 2008 O.J. (C115) 91–92 [hereinafter TFEU].

114 *Id.; State Aid*, EUR. COMM'N https://ec.europa.eu/competition/state_aid/overview/index_en.html (last visited Oct. 22, 2021).

115 *State Aid (Notion)*, CONCURRENCES, https://www.concurrences.com/en/dictionary/state-aid (last visited Oct. 22, 2021).

1. There has been intervention by the State or through State Resources which can take a variety of forms;
2. The intervention gives the recipient an advantage on a selective basis, for example to specific companies or industry sectors, or to companies located in specific regions;
3. Competition has been or may be distorted; and
4. The intervention is likely to affect trade between Member States.[116]

While the treaty is a general prohibition against State Aid, it does allow for several exceptions based on policy objectives with which State Aid can be considered compatible.[117] The treaty itself explicitly outlines these exemptions and the laws are routinely reviewed and updated to improve efficiency and to provide targeted aid to boost the economy.[118] The adoption of the updates is done in close cooperation with the Member States.[119]

Moreover, the treaty has a number of transparency requirements, with a provision that creates a "state aid transparency public search."[120] This "search" gives citizens and companies access to information listing individual award data provided by Member States.[121] This data includes the name of the beneficiary, amount of the award, location, sector, and objective.[122] While this portion of the EU's State Aid Control Treaty could be used to address the issue of the prisoner's dilemma found as part of the state-level tax incentive bidding process, that is not the focus of this Note.[123]

The EU's State Aid Control Treaty will be used in this Note as the basic framework on which to establish the proposed legislation of this Note in the United States.

B. The Need for The United States to Adopt a Domestic Version

There is currently no national legislation in the United States regulating the act or process of states awarding tax incentives to businesses. While this lack of legislation may be attributed to the reverence the Country holds for state sovereignty, it is evident that a lack of regulation has led to a circumstance even more unsettling than a minor infringement on the power of states—the United States is being divided through

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116 *Id.*

117 TFEU, *supra* note 113.

118 *Id.*

119 *State Aid (Notion)*, *supra* note 115.

120 *State Aid Transparency Public Search*, EUR. COMM'N, https://webgate.ec.europa.eu/competition/transparency/public?lang=en (last updated Jan. 7, 2016).

121 *Id.*

122 *Id.*

123 *See* discussion *supra* Part II.B.

economic warfare over businesses.[124] The Constitution was not created to empower individual states at the expense of the entire Nation, but was rather created to unify states so cooperation would benefit the greater good.[125] While it is recognized that the proposed legislation in this Note will invade on the power states hold today, this minor infringement should not dissuade even the most passionate states' right advocates.

Legislation modeled after the European Union's State Aid Control Treaty, with its underlying theory grounded in the dormant Commerce Clause, will do no more than take away a state's ability to grant unconstitutional discriminatory tax incentives. States will still enjoy the ability to grant economic development incentives that align with the legislation, and states will possess the power to influence the legislation through congressional representation. The legislation will prevent businesses from exploiting states for incentive packages, as the types of incentives allowed to be offered will be limited to the confines of the theory underlying the dormant Commerce Clause. Concurrently, the ineffectiveness of the case-by-case system currently in place to enforce the anti-discrimination principle of the Commerce Clause will be corrected by removing the analysis from the labyrinthine court system.

As will be seen in the next Part, the United States already has the legal infrastructure to enact an effective domestic version of the European Union's State Aid Control Treaty.

V. THE PROPOSED LEGISLATION AND CONGRESS' POWER TO ENACT FEDERAL LEGISLATION

In Part V, the proposed legislation of this Note is revealed, and the constitutionality of the legislation is proven. In Subpart A, it is argued that, given the nexus between discriminatory behavior under the Commerce Clause and anti-competitive action by businesses, Congress should use the expertise of the Federal Trade Commission to enforce the proposed legislation of this Note. In Subpart B, the proposed legislation of this Note is announced. This proposed legislation is molded by the European Union's State Aid Control Treaty but is modified to accommodate for the distinct legal doctrines of the United States. In Subpart C, an overview of the Commerce Clause is given: the Commerce Clause is the legal authority that empowers Congress to enact the legislation proposed by this Note. Under the Commerce Clause, the proposed legislation of this Note is constitutional.

A. Incorporating the United States Anti-Trust Laws

While the framework of the European Union's State Aid Control Treaty establishes the groundwork to enact legislation regulating state tax incentives in the United States, the United States may also call on its anti-trust regulations to effectuate a domestic version of the treaty. The United States' anti-trust laws are statutes designed to "ensure that fair competition exists in an open-market economy."[126] This

124 *Id.*

125 Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 223 (1824) (Johnson, J., concurring).

126 James Chen, *Understanding Antitrust Laws*, INVESTOPEDIA (July 31, 2020), https://www.investopedia.com/ask/answers/09/antitrust-law.asp#:~:text=Antitrust%20laws%20are%20statutes%20developed,%2C%20price%20fixing%2C%20and%20monopolies.

goal is not so different from that of the dormant Commerce Clause which prohibits states from "passing legislation that discriminates against or excessively burdens interstate commerce" and prevents "protectionist state policies that favor state . . . businesses at the expense of non-citizens conducting business within that state."[127] The commonality between the dormant Commerce Clause and the United States' anti-trust laws is the goal of protecting against distorted competition in markets. Having established this interrelation, it is evident that Congress can use the United States' anti-trust laws as a basis for supporting necessary legislation to regulate state tax incentives.[128]

As stated, the United States' anti-trust laws are designed to "ensure that fair competition exists in an open-market economy."[129] These anti-trust laws include the "Big Three" anti-trust laws: the Sherman Act, the Clayton Act, and the Federal Trade Commission Act.[130] While the Sherman Act and the Clayton Act are part of the groundwork of the anti-trust laws in the United States, this Note relies on the Federal Trade Commission Act for support. The Federal Trade Commission Act bans "unfair methods of competition" and "unfair or deceptive acts or practices."[131] Moreover, the Federal Trade Commission Act established the Federal Trade Commission (FTC), a federal agency, which has the expertise to bring cases under the Act.[132] In recognition of the expertise of the agency, the FTC is the only federal agency that brings cases under the Federal Trade Commission Act.[133]

The described scope of the Federal Trade Commission Act highlights the similarity between actions discriminatory to interstate commerce under the Commerce Clause and anti-competitive behavior under the United States' anti-trust laws. This nexus suggests that the FTC is equipped to enforce the provisions of the proposed legislation

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[127] Legal Information Institute, *Commerce Clause: "Dormant" Commerce Clause*, CORNELL LAW SCH., https://www.law.cornell.edu/wex/commerce_clause; *see also* West Lynn Creamery Inc. v. Healy, 512 U.S. 186 (1994) (holding that a state tax on milk products discriminated against out-of-state producers of milk products in violation of the dormant Commerce Clause).

[128] One may wonder why the United States anti-trust laws alone should not be used to bring an end to discriminatory tax incentives. However, the anti-trust laws of the United States cannot be applied directly to states because states are not a "person" under the Acts. Parker v. Brown, 317 U.S. 341, 351 (1943). State officials are immune from federal anti-trust lawsuits for actions taken pursuant to a clearly expressed state policy because nothing in the language of the federal anti-trust laws or their history suggests that "Congress intended to restrict the sovereign capacity of the States to regulate their economies", and therefore, the anti-trust laws "should not be read to bar States from imposing market restraints 'as an act of government.'" FTC v. Phoebe Putney Health Sys., Inc., 568 U.S. 216, 224 (2013) (quoting Parker v. Brown, 317 U.S. 341, 352 (1943)). This doctrine is known as the "state-action immunity." *Id.* at 225.

[129] Chen, *supra* note 126.

[130] *Id.*; Sherman Antitrust Act of 1890, 15 U.S.C. §§ 1–38; Clayton Antitrust Act of 1914, 15 U.S.C. §§ 12–27; Federal Trade Commission Act of 1914, 15 U.S.C. §§ 41–58.

[131] Federal Trade Commission Act of 1914, 15 U.S.C. § 45.

[132] *Id.* § 41.

[133] *Id.* § 45.

in this Note. The expertise of the FTC combined with the general framework of the European Union's State Aid Control Treaty would act as an effective measure in replacing the current practice of analyzing discriminatory state tax incentives on a case-by-case basis through litigation.

B. The Proposed Legislation

The EU's State Aid Control Treaty is a general prohibition against State Aid.[134] State Aid is "an advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities."[135] However, as has been noted throughout this Note, not all uses of public monies given on a selective basis are unlawful in the United States.[136] Thus, adopting legislation as sweeping in scope as the EU's State Aid Control Treaty would be incompatible with the laws of this Nation.

Rather, the legislation that Congress should implement should be focused solely on preventing states from implementing discriminatory tax incentives. To do so, the EU's State Aid Control Treaty should be adjusted to conform with this goal. Rather than defining "State Aid" as support with the features of:

1. There has been intervention by the State or through State Resources which can take a variety of forms;
2. The intervention gives the recipient an advantage on a selective basis, for example to specific companies or industry sectors, or to companies located in specific regions;
3. Competition has been or may be distorted; and
4. The intervention is likely to affect trade between Member States;[137]

Congress should replace "State Aid" with "state tax incentives" with the following features:

1. A State has offered an advantage in the form of a tax incentive;
2. The advantage was offered to a specific business on a selective basis in that the tax incentive is not available to all the businesses within the state;
3. Competition in the market has been or may be distorted; and
4. The intervention is likely to affect or may affect interstate commerce.

Moreover, instead of adopting the EU's State Aid Control Treaty's general prohibition, Congress should capitalize on the expertise of the FTC to enforce this new legislation. Thus, the scope of the FTC's power would be extended to include review authority over state tax incentive action. To circumvent the barriers of litigation, states, when offering a tax incentive to a selective business, would have it reviewed by the FTC. The FTC would be advised to use their expertise to determine if a tax incentive

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134 TFEU, *supra* note 113.

135 *State Aid (Notion)*, *supra* note 115.

136 *See* discussion *supra* Part III.C.

137 *State Aid (Notion)*, *supra* note 115.

would have a discriminatory effect under the Commerce Clause. If so, the state would be barred from continuing to implement that tax incentive if it does not further some legitimate state interest, as declared in the legislation.

In line with the market-participant exception and the "legitimate state interest" exception derived from the Supreme Court's Commerce Clause jurisprudence, this proposed legislation would contain exceptions to its general rule, just as the EU's State Aid Control Treaty does. The EU's State Aid Control Treaty may allow State Aid if it is justified by objectives that support the general welfare such as "aid to promote the development of disadvantaged areas or for services of general economic interest, small and medium-sized enterprises, research and development, environmental protection, training, employment and culture."[138] Congress should adopt the same approach in this legislation. Tax incentives, such as historical tax credits, research and development tax credits, and job training tax credits, could all be exceptions to the legislation's general rule. Furthermore, state-offered subsidies and other economic development tools would not be subject to review.

This proposed legislation would uphold the Commerce Clause jurisprudence of the United States, capitalize on the agency expertise of the FTC, and eliminate the inefficiencies currently in place under the case-by-case analysis of discriminatory state tax incentives. The proposed legislation leaves the sovereignty of each state intact, leaving them the power to formulate and impose tax incentives as they see fit by only limiting the imagination and ingenuity of these state officials to the confines of the Constitution.

C. Power to Enact the Legislation under the Commerce Clause

The Commerce Clause gives Congress the power "to regulate commerce with foreign nations, and among the several States, and with the Indian Tribes."[139] Congress has repeatedly used this provision of the Constitution to enact legislation regulating businesses and their practices.[140] The ability of Congress to regulate under the Commerce Clause is limited to activities that are encompassed under the broad umbrella of commercial intercourse among the states.[141] Commercial intercourse includes (i) activities that use the channels of interstate commerce (ii) activities that involve the use of instrumentalities of interstate commerce, and (iii) activities that substantially effect interstate commerce.[142]

Channels refer to the pathways of facilitating interstate commerce such as highways, waterways, airways used by planes, and even hotels or restaurants.[143] Instrumentalities refer to the means by which interstate commerce occurs, which

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[138] *Glossary of Summaries: State Aid*, EUR. UNION, https://eur-lex.europa.eu/summary/glossary/state_aid.html (last visited Oct. 22, 2021).

[139] U.S. CONST. art. 1, § 8, cl. 3.

[140] *See* discussion *infra* Part V.C.

[141] Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 189–90 (1824) (Johnson, J., concurring).

[142] United States v. Lopez, 514 U.S. 549, 558–59 (1995).

[143] *See, e.g.*, United States v. Darby, 312 U.S. 100 (1941); Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241 (1964).

includes things in interstate commerce such as cars, trucks, ships, airplanes, and people in interstate commerce.[144] Congress' ability to regulate under the Commerce Clause is at its strongest if channels or instrumentalities are involved; however, if these two categories are absent from legislation, Congress may be able to regulate an activity if it meets the substantial effects test.[145]

If Congress is regulating a channel or instrumentality of interstate commerce, then no further analysis is needed, and Congress will be found to have the power to regulate these matters under the Commerce Clause.[146] However, the analysis using the substantial effects test is more nuanced.

The substantial effects test starts with a threshold question: is the matter in question an activity or inactivity?[147] If the matter is an activity then the analysis continues, if the matter is an inactivity then the regulation is considered unconstitutional.[148] After passing through the threshold question, the next determination that must be made is whether the activity is economic or non-economic?[149] Economic activity is defined as, "the production, distribution or consumption" of a commodity or service.[150]

After determining if the activity is economic or not, the test splits into two different analyses: one for economic activity and one for noneconomic activity. Under the economic activity test, Congress may regulate an economic activity if there is a rational basis to conclude that the activity, in the aggregate, would have a substantial effect on interstate commerce.[151] Under the noneconomic activity test, Congress may regulate the activity if there is a jurisdictional element in the legislation making a connection to interstate commerce.[152] If there is not a jurisdictional element then Congress may only regulate the noneconomic activity if there are congressional

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[144] *See, e.g.*, Houston, E. & W.T.R. Co. v. United States, 234 U.S. 342 (1914); Southern R. Co. v. United States, 222 U.S. 20 (1911).

[145] Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519, 549 (2012).

[146] *Houston*, 234 U.S. at 351 (holding Congress has the power to regulate instrumentalities); *see also* Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 253 (1964) (stating that a hotel could be considered a channel of interstate commerce and thus Congress would have the power to regulate them).

[147] *Sebelius*, 567 U.S. at 550.

[148] *Id.* at 552.

[149] *See* Katzenbach v. McClung, 379 U.S. 294 (1964) (holding that if Congress has a rational basis to conclude that an economic activity, in the aggregate, has a substantial effect on interstate commerce then Congress can regulate the activity); United States v. Lopez, 514 U.S. 549 (1995) (holding that congress may only regulate a noneconomic activity if there is an interstate jurisdictional issue, there is congressional findings that the activity would effect interstate commerce and that there is a sufficient nexus between the activity and interstate commerce).

[150] Gonzalez v. Raich, 545 U.S. 1, 24 (2005).

[151] *Katzenbach*, 379 U.S. at 304.

[152] *Lopez*, 514 U.S. at 561.

findings that the activity would affect interstate commerce.[153] In the case of noneconomic activity there must be a nexus between the activity and interstate commerce, or stated differently, that the link between the activity and interstate commerce cannot be too attenuated.[154]

Here, if Congress adopts the framework of the European Union's State Aid Control Treaty, they will by nature be regulating the instrumentalities and channels of interstate commerce. The proposed legislation regulates the states' ability to give incentives to businesses in interstate commerce. Thus, the subject of the regulation is businesses in interstate commerce. By the nature of this classification, the businesses that would be subject to this regulation are instrumentalities of interstate commerce because businesses are the vehicles by which interstate commerce is carried out.[155] Moreover, some of the businesses would also fall under the channel's category of the Commerce Clause analysis because the Supreme Court has established that businesses such as restaurants and hotels are to be considered channels of interstate commerce.[156]

However, if this proposed legislation were to be challenged in court and creative lawyering established that the subject of the legislation was not businesses, but rather the incentives themselves, the regulation would still pass judicial scrutiny under the substantial effects test.

As noted, the substantial effects test has been applied by the Court differently depending on the activity under consideration.[157] The threshold question, no matter the activity under scrutiny, is whether the matter being regulated is an activity or an inactivity.[158] As intuition would lead, an activity is the act of doing something, while a non-activity is the state of not doing something. The Court has stated that a person

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153 *Id.* at 561–68.

154 *Id.*

155 Houston, E. & W.T.R. Co. v. United States, 234 U.S. 342 (1914) (holding Congress has the power to regulate instrumentalities of interstate commerce).

156 Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 253 (1964) (stating that a hotel could be considered a channel of interstate commerce); *Katzenbach*, 379 U.S. at 302 (stating that a restaurant could be considered a channel of interstate commerce).

157 *See* United States v. Darby, 312 U.S. 100 (1941) (holding that Congress may regulate an intrastate activity in order to achieve an legitimate end if it has an effect on interstate commerce); Wickard v. Filburn, 317 U.S. 111 (1942) (holding that Congress may regulate a local activity if in the aggregate the activity would have a substantial economic effect on interstate commerce); *Heart of Atlanta Motel*, 379 U.S. at 241 (holding that Congress may prohibit discriminatory policies by hotels because in the aggregate the policies have a substantial effect on interstate commerce); *Katzenbach*, 379 U.S. at 304 (1964) (holding that if Congress has a rational basis to conclude that an economic activity, in the aggregate, has a substantial effect on interstate commerce then Congress can regulate the activity); *Lopez*, 514 U.S. at 549 (holding that Congress may only regulate a noneconomic activity if there is an interstate jurisdictional issue, there is congressional findings that the activity would effect interstate commerce and that there is a sufficient nexus between the activity and interstate commerce).

158 Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519, 550 (2012).

not enrolling in health insurance is considered an inactivity,[159] but there is no congruency of that situation to the matter at hand. Here, Congress is regulating the state's ability to give economic incentives to businesses within their state. By the nature of this legislation, states must be acting to fall under the legislation. Thus, Congress would be regulating an activity in the federal legislation which adopts the framework of the European Union's State Aid Control Treaty.

The next step is to determine whether the activity is economic or noneconomic. Economic activities have been considered acts such as implementing employment regulations, growing home-grown crops, and acts related to loan sharking.[160] Here, the activity being regulated is a state's ability to give economic incentives to businesses. Thus, this regulation is focused on economic activity, as any business receiving an incentive will be involved in either production, distribution, or consumption of a commodity or service. When an activity is deemed economic, the Court has implemented a rational basis test that considers whether Congress could reasonably believe that the activity would substantially affect interstate commerce.[161] Under judicial scrutiny, this proposed legislation would easily pass this test. It would only be necessary to find that there is a rational basis for believing that tax incentives given to businesses would substantially affect interstate commerce.[162] This would not be difficult to establish as economic development incentives account for between $45 to $90 billion per year of public monies being added into the economy—an obvious rational basis for concluding that economic development incentives have a substantial effect on interstate commerce.[163] An analysis using the strict scrutiny test is not necessary to indulge in as this legislation, if not concerning channels or instrumentalities, would be found to be concerning economic activity.

Nonetheless, finding that Congress has the power to regulate a subject does not end the analysis; Congress' power to regulate is limited by Tenth Amendment.[164] The Court has held that Congress cannot "commandeer" states to pass legislation according to congressional direction; in other words, Congress does not have the power to regulate state governments' regulation of commerce.[165] Moreover, the Court has repeatedly recognized the importance of states acting as "laboratories" to try novel social and economic experiments.[166]

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159 *Id.*

160 United States v. Darby, 312 U.S. 100 (1941) (stating that the activity of employment regulation is economic activity); *Wickard*, 317 U.S. at 111 (stating growing wheat at home is economic activity); Perez v. United States, 402 U.S. 146 (stating that loansharking is economic activity).

161 *Heart of Atlanta Motel*, 379 U.S. at 258.

162 *Id.*

163 Parilla and Liu, *supra* note 20.

164 U.S. CONST. amend. X.

165 New York v. United States, 505 U.S. 144, 161 (1992).

166 New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting); *see also* West Lynn Creamery v. Healy, 512 U.S. 186, 196 (1994) (Rehnquist, C.J., dissenting).

Importantly, this proposed regulation will not "commandeer" states to pass legislation under the direction of Congress; rather, it will only prohibit states from granting economic development incentives that are contrary to the anti-discrimination provision of the Commerce Clause.[167] That is, this proposed legislation only prevents states from using economic development incentives that are themselves unconstitutional. Secondly, in addressing the "laboratories" assertion, it would be illogical, and illegal, to extend this contention to include experimentation with unconstitutional ideas.

In conclusion, because this legislation can be found to be concerning instrumentalities of interstate commerce, channels of interstate commerce, or economic activity that substantially affects interstate commerce, Congress has the power under the Commerce Clause to regulate these incentive packages. Furthermore, this proposed legislation does "commandeer" states to pass legislation under the direction of Congress, but only prohibits the granting of otherwise unconstitutional incentives. Thus, this proposed legislation is legal as it passes constitutional scrutiny.

VI. CONCLUSION

The competition among states to attract businesses gives no indication of seizing. States will continue to attempt to attract businesses for the benefits that these companies represent; whether it be job growth numbers, the possible future tax revenue the companies represent, or the pure political win attracting a business provides. As part of this competition, state-level tax incentives will continue to play a role, and thus, it is imperative that the tax incentives offered are within the limits of the Constitution. The Constitution, as seen through dormant Commerce Clause jurisprudence, makes it unlawful for states to implement tax incentives that discriminate against interstate commerce.[168]

Currently, state-level tax incentives are unregulated by the federal government; the only safeguard to ensuring the constitutionality of state-level tax incentives is the case-by-case analysis by the United States judiciary. This case-by-case analysis suffers from inefficiencies because this system requires litigants to bring a suit against a state while facing both procedural and political barriers.[169] Moreover, states have shown that they are willing to push the barriers of the constitutional limits on tax incentives in order to compete for businesses. States either disregard the tax incentive jurisprudence or misapply the exceptions to this jurisprudence when formulating tax incentives. Given the importance of the cooperation between states to the Nation as a whole and the necessity of ensuring businesses compete in a free market, this case-by-case system of inefficiencies that regulates opportunistic states is insufficient to uphold the anti-discrimination principle of the Commerce Clause.

The European Union's State Aid Control Treaty offers a framework for enacting legislation in the United States to prevent the continuation of discriminatory tax incentives. Currently, states compete for business with what are arguably discriminatory incentives, and given the mechanisms of the bidding process, these

167 *See* Fort Gratiot Sanitary Landfill v. Mich. Dep't of Nat. Res., 504 U.S. 353, 359 (1992) (quoting H.P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 535 (1959)).

168 *Healy*, 512 U.S. at 388.

169 *See* DaimlerChrystler Corp. v. Cuno, 547 U.S. 332 (2006).

incentives exploit the resources of all states involved—hurting not only the states that lose the incentive bidding war but, paradoxically, the state that wins the bidding war as well. Enacting legislation modeled after the EU's State Aid Control Treaty would provide a means to ensure that all state-level tax incentives are within the bounds of the Constitution.

By enacting this legislation, states will be forced to compete for businesses with incentives that do not discriminate against interstate commerce, and such a requirement will work to save states from each other by limiting offered incentives to those that are in pursuit of a "legitimate state interest." This limit will also restrain the ability of businesses to exploit states for artificially inflated incentive packages as states will be required to prove the legitimacy of the incentives offered within the confines of the Constitution, likely limiting the breadth of incentives offered from what they are today.

Thus, given the limits of the dormant Commerce Clause in effectuating change through litigation, ending the economic war among states requires the theory underlying the dormant Commerce Clause to be promulgated into federal legislation modeled after the European Union's State Aid Control Treaty.