

May 9, 2012

Volume 16, Issue 17

The Airbus—Boeing Subsidy Dispute: With Both Parties in Violation, Is There an End in Sight?

By Simon Lester



Introduction

The U.S.—EU dispute over subsidies to the large civil aircraft (“LCA”) industry has become one of the most complex, lengthy, and expensive disputes in the history of the GATT/WTO. In its most recent iteration, it has taken up eight years in the WTO dispute settlement process, with more still to come. The

United States has been the aggressor in the case, voicing strong complaints about the “launch aid” provided by EU and member state governments to Airbus-related companies. But the EU has always pushed back strongly, asserting that aid to Boeing and related companies is just as big of a problem, if not more so.

In terms of the substance, each party has argued that the other’s subsidies to its LCA industry violate the WTO Agreement on Subsidies and Countervailing Measures (“SCM Agreement”).^[1] In this regard, each has claimed that some subsidies constitute export subsidies prohibited by SCM Agreement Article 3.1, and that some subsidies are “actionable subsidies” which violate SCM Agreement Article 5 because they cause “adverse effects.” The actionable subsidies claims have focused on “serious prejudice to the interests of another member,” which under SCM Agreement Article 6.3 includes cases where a subsidy has the effect of “displacing” or “impeding” imports of a like product into the market of the subsidizing member (Article 6.3(a)); or “displacing” or “impeding” the exports of a like product in a third country market (Article 6.3(b)); or significant price suppression or lost sales in the same market (Article 6.3(c)).

In March and April 2012, the dispute moved ahead. On March 23, the WTO’s Dispute Settlement Body (“DSB”) adopted the WTO Appellate Body report in *U.S.—Aircraft*, confirming that U.S. federal and state subsidies to Boeing breach U.S. WTO obligations. Then, in April, the DSB established a panel to examine the EU’s alleged failure to comply with the May 2011 Appellate Body report in the *EC—Aircraft* case, which had found that EU subsidies to Airbus breach EU WTO obligations. In the *EC—Aircraft* dispute, the Appellate

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Body confirmed in May 2011 that EU subsidies to Airbus cause adverse effects to Boeing. Soon after the six-month compliance deadline expired, the United States initiated compliance proceedings against the EU and also requested DSB authorization to retaliate against \$7-10 billion per year in imports of EU goods and services, arguing that the EU had failed to comply with the DSB rulings.[2] The parties then agreed to defer the issue of retaliation until completion of the compliance proceedings.[3] On March 30, 2012, the United States requested a panel under Article 21.5 of the WTO Dispute Settlement Understanding[4] to review EU compliance in *EC—Aircraft*. [5] The DSB established the panel at its meeting on April 13. A key issue in this dispute will be whether the launch aid for the Airbus A350 aircraft will be found to be within the scope of review.

As for the *U.S.—Aircraft* dispute, the Appellate Body issued its report on March 14, 2012, and the DSB adopted the report, together with the panel report, on March 23, 2012. On April 13, the United States said it would comply with the *U.S.—Aircraft* reports within six months from the date of adoption (i.e., by September 23, 2012), as set out in the SCM Agreement. The remaining part of this *Insight* will focus on the key aspects of the legal issues in the *U.S.—Aircraft* case.

The Subsidies at Issue in *U.S.—Aircraft*

This dispute concerned U.S. subsidies to U.S. LCA producers (e.g., the Boeing Company and the McDonnell Douglas Corporation, prior to its merger with Boeing), including state and local government programs in Illinois, Kansas, and Washington State, federal programs of the National Air and Space Administration (“NASA”) and the U.S. Departments of Defense (“DoD”), Commerce (“DOC”), and Labor (“DOL”), and federal tax incentives. For each program, the panel first examined whether the subsidy was specific to an enterprise or industry. Some programs did not meet this test.[6]

As explained by the Appellate Body, for the purposes of its analysis of the trade effects of the subsidies, the panel had divided into three groups the measures found to constitute “specific subsidies.” The Appellate Body referred to these groups as: the “aeronautics R&D subsidies;” the “tied tax subsidies;” and the “remaining subsidies.”[7] The Appellate Body described these groups as follows:

- *Aeronautics R&D subsidies*, valued at approximately \$2.6 billion and including: (i) payments made to Boeing and access to NASA facilities, equipment, and employees provided to Boeing by NASA pursuant to procurement contracts and Space Act Agreements entered into under eight aeronautics R&D programmes; and (ii) payments made to Boeing and access to DoD facilities provided to Boeing pursuant to assistance instruments entered into under twenty-three DoD research, development, training, and education (RDT&E) programmes.[8]
- *Tied tax subsidies*, valued at approximately \$2.2 billion and including: (i) federal tax exemptions and tax exclusions for Boeing under the Foreign Sales Corporation/Extraterritorial Income (“FSC/ETI”) legislation; (ii) Washington State’s special reduction in its business and occupation (“B&O”) tax rate for Boeing; and (iii) a similar B&O tax rate cut for Boeing by the City of Everett, Washington, the site of a Boeing plant.[9]

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- Eight *remaining subsidies*, valued at approximately \$550 million and including: (i) property and sales tax abatements provided to Boeing pursuant to industrial revenue bonds (“IRBs”) issued by the City of Wichita, Kansas; (ii) Washington State B&O tax credits for preproduction development, computer software and hardware, and property taxes; (iii) Washington State sales and use tax exemptions for computer hardware, peripherals, and software; (iv) the Washington State workforce development programme and Employment Resource Center; (v) reimbursement of a portion of Boeing’s relocation expenses by the State of Illinois; (vi) the fifteen-year Economic Development for a Growing Economy (“EDGE”) tax credits provided by the State of Illinois; (vii) an abatement or refund of a portion of Boeing’s property taxes provided by the State of Illinois; and (viii) a payment to retire the lease of the previous tenant of Boeing’s new headquarters building in Chicago, Illinois.[10]

The Claims

The EU claimed that certain Washington State tax incentives and the Federal “FSC/ETI” income tax breaks are export subsidies prohibited under SCM Agreement Article 3. The EU also claimed that all of the subsidies are “actionable” under the SCM Agreement and that by using these subsidies, the United States has caused and continues to cause “adverse effects,” in particular “serious prejudice,” to the interests of the EU within the meaning of Articles 5(c), 6.3(a), (b), and (c) of the SCM Agreement.[11]

The Panel Decision

a. *Export Subsidy Claims*

The panel found that the FSC/ETI subsidies were export subsidies inconsistent with SCM Agreement Articles 3.1(a) and 3.2. However, because this measure was no longer in force for Boeing, and because an earlier panel’s recommendation regarding this program was still operative, the panel did not make any recommendation for this program.[12] The panel then found that the EU failed to demonstrate that the Washington State tax incentives were tied to exportation (or were otherwise export subsidies). These findings were not appealed.

b. *“Serious Prejudice” Claims*

With respect to “serious prejudice” claims, the panel found that:

- The effect of the aeronautics R&D subsidies with respect to the 200-300 seat wide-body LCA product market threatens to displace and impede European Communities’ exports from third country markets within the meaning of Article 6.3(b), and amounts to significant lost sales and significant price suppression within the meaning of Article 6.3(c) with respect to that product market, constituting serious prejudice;
- The effect of the FSC/ETI subsidies and the State of Washington B&O tax subsidies is displacement and impedance of European Communities’ exports from third country markets within the meaning of Article 6.3(b) with respect to the 100-200 seat single-aisle LCA product market, and significant price suppression and significant

lost sales within the meaning of Article 6.3(c) in that product market;

- The effect of the FSC/ETI subsidies, the State of Washington B&O tax subsidies, and the City of Everett B&O tax subsidies is displacement and impedance of European Communities' exports from third country markets within the meaning of Article 6.3(b) with respect to the 300-400 seat wide-body LCA product market, and significant price suppression and significant lost sales within the meaning of Article 6.3(c) in that product market.

The panel was not persuaded that the other Washington State tax subsidies and the property and sales tax abatements provided pursuant to IRBs issued by the State of Kansas and its municipalities, or the tax credits and other incentives provided by the State of Illinois and its municipalities, cause serious prejudice in any of the relevant three LCA product markets.

Appellate Body Decision

The appeal dealt with a long list of issues related to the subsidies' existence and specificity, and whether the subsidies caused adverse effects in the form of serious prejudice. Some of the appeals were straightforward claims of legal error; others alleged that the panel did not make an "objective assessment" of the matter or of the facts.

a. Existence of Subsidies

SCM Agreement Article 1 provides that a subsidy exists if there is a "financial contribution," and a "benefit" is thereby conferred. The panel had found that the NASA and the DoD contracts with Boeing were a payment for R&D services, and that Article 1 excludes purchases of services from the definition of a subsidy. The Appellate Body declared this finding to be "moot and of no legal effect;" it found that these contracts were not just a payment for R&D services but collaborative arrangements akin to an equity infusion (and thus constitute a financial contribution). The Appellate Body also upheld the panel's finding that Washington State's special B&O tax rate for commercial aircraft and component makers foregoes revenue otherwise due and is therefore a financial contribution.

b. Specificity of Subsidies

The Appellate Body applied the rules in SCM Agreement Article 2.1(a) and (c) to particular subsidy measures, including the Washington State B&O tax cut and the City of Wichita IRBs.

c. Adverse Effects/Serious Prejudice

The Appellate Body upheld many of the appealed findings, but it modified several others. Notable conclusions include the following:

- The Appellate Body upheld the panel findings that "the aeronautics R&D subsidies contributed in a genuine and substantial way to Boeing's development of technologies for the 787" in 2004 and that but for the effects of these subsidies, Airbus would not have suffered serious prejudice. It rejected a U.S. appeal that the panel erred by failing to identify and establish third-country "markets" in Iceland, Kenya, and Ethiopia within the meaning of Article 6.3(b); however, it reversed the

panel's finding that there was a threat of displacement and impedance in those same third-country markets. Overall, the Appellate Body *modified and upheld* the panel's conclusion that the aeronautics R&D subsidies, through their technology effects, caused serious prejudice within the meaning of SCM Agreement Articles 5(c) and 6.3(b) and (c) with respect to the 200-300 seat LCA market.[13]

- With respect to the “price effects” of the *tied tax subsidies*, the Appellate Body concluded that the panel had erred in its analysis of serious prejudice in the 100-200 seat and 300-400 seat LCA markets. It therefore reversed the panel's findings under Articles 5(c) and 6.3(b) and (c). While—based on the facts in the panel record—the Appellate Body could only complete its analysis for two sales campaigns in the 100-200 seat LCA market, for those campaigns it found a “genuine and substantial causal relationship” (based on price effects) between the FSC/ETI subsidies and the Washington State B&O tax rate reduction, and significant lost sales for Airbus in these two sales campaigns. It therefore found that these two programmes caused serious prejudice to EU interests in the 100-200 seat LCA market.[14]
- Regarding “collective assessment” of the three different subsidy groups, the Appellate Body found that the panel erred by (a) failing to consider whether the price effects of the B&O tax rate reductions complement and supplement the technology effects of the aeronautics R&D subsidies in causing lost sales, price suppression, and a threat of displacement and impedance in the 200-300 seat LCA market, and (b) concluding that the price effects of the remaining subsidies did not cause serious prejudice, without having considered whether those subsidies contributed to the serious prejudice caused by Boeing's LCA pricing. Completing the analysis, the Appellate Body found that the effects of the City of Wichita IRBs complemented and supplemented the price effects of the FSC/ETI subsidies and the State of Washington B&O tax rate reduction, thereby causing serious prejudice, in the form of significant lost sales, within the meaning of SCM Agreement Articles 5(c) and 6.3(c), in the 100-200 seat LCA market.[15]

Of particular systemic interest here were the Appellate Body's findings on the nature of the causation analysis for the tied tax subsidies, as well as its discussion of how to “aggregate” or “cumulate” the effects of multiple subsidies.

Reading the panel and Appellate Body findings on “serious prejudice” together, the Appellate Body's ruling narrows the panel's “adverse effects” findings in some ways and expands it slightly in others. The end result is that a significant amount of U.S. subsidies to Boeing cause adverse effects and must be withdrawn within six months of the March 23 adoption of the reports.

Implementation and Compliance

The United States now faces a difficult task in implementation. The subsidies at issue come from a wide range of government entities at the federal, state, and local levels. An orderly, coordinated withdrawal of all the subsidies will be difficult to achieve. Instead, the United States may focus on particular federal subsidies over which the Executive Branch

has the most control. It may hope that by changing these subsidies in some way and to some degree, it can achieve compliance even if particular subsidies remain. Complicating the matter is that some federal subsidies have already been subject to WTO dispute recommendations (the FSC/ETI subsidies), and some new state subsidies (in South Carolina) have recently been instituted. In all likelihood, this dispute will eventually see an EU challenge to U.S. compliance attempts, as currently underway in *EC—Aircraft*.

Of course, there is always the possibility that the parties will settle. However, with the way the United States continues to press forward in *EC—Aircraft*, this seems unlikely.

About the Author:

Simon Lester, a former Legal Affairs Officer at the Appellate Body Secretariat of the World Trade Organization, has taught courses on international trade law at American University's Washington College of Law and the University of Michigan Law School. He is co-founder of WorldTradeLaw.net, the leading online source of information and analysis on [WTO dispute settlement](#).

Endnotes:

[1] WTO Agreement on Subsidies and Countervailing Measures, 1867 U.N.T.S. 14, *available at* http://www.wto.org/english/docs_e/legal_e/24-scm.pdf.

[2] Request for Authorisation to Suspend Concessions by the United States, *European Communities and Certain Member States—Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/18 (Dec. 9, 2011), *available at* <http://docsonline.wto.org/DDFDocuments/t/WT/DS/316-18.doc>; Request for Consultation with the European Union by the United States, WT/DS316/18 (Dec. 9, 2011), *available at* <http://docsonline.wto.org/DDFDocuments/t/WT/DS/316-19.doc>.

[3] Understanding Between the European Union and the United States Regarding Procedures Under Articles 21 and 22 of the DSU, *European Communities and Certain Member States—Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/21 (Jan. 21, 2012), *available at* <http://docsonline.wto.org/DDFDocuments/t/WT/DS/316-21.doc>.

[4] WTO Understanding on Rules and Procedures Governing the Settlement of Disputes, 1869 U.N.T.S. 401; 33 I.L.M. 1226 (1994), *available at* http://www.wto.org/english/docs_e/legal_e/28-dsu.pdf.

[5] Request for the Establishment of a Panel by the United States, *European Communities and Certain Member States—Measures Affecting Trade in Large Civil Aircraft*, WT/DS318/23 (Mar. 30, 2012) (circulated on Apr. 3, 2012), *available at* <http://docsonline.wto.org/DDFDocuments/t/WT/DS/316-23.doc>.

[6] Examples of programs which did not meet this test include infrastructure improvements near the Boeing plant in Everett, Washington; waiver of landing fees for Boeing large cargo freighters.

[7] Appellate Body Report, *United States—Measures Affecting Trade in Large Civil Aircraft*, ¶ 892, WT/DS353/AB/R (Mar. 12, 2012), *available at* http://www.wto.org/english/tratop_e/dispu_e/353abr_e.pdf [hereinafter AB Report].

[8] *Id.* ¶ 893.

[9] *Id.* ¶ 894.

[10] *Id.* ¶ 895.

[11] Panel Report, *United States—Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, ¶ 3.1, WT/DS353/R (Mar. 31, 2011), *available at* http://www.wto.org/english/tratop_e/dispu_e/353r_e.pdf.

[12] *Id.* ¶¶ 8, 6-7.

[13] AB Report, *supra* note 7, ¶¶ 923-1127.

[14] *Id.* ¶¶ 1146-1274.

[15] *Id.* ¶¶ 1275-1348.