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Aircraft Subsidies

Stephan Wittig*

The WTO Panel Report on Boeing Subsidies: a Critical Assessment

On 31 March 2011, the World Trade Organisation’s Dispute Settlement Body circulated the final Panel Report on US subsidies for the aircraft manufacturer Boeing. The long expected decision marks a turning point in the biggest trade dispute in WTO history, but its interpretations diverge substantially: both the United States and the European Union have claimed a “sweeping” victory, and yet both parties appealed parts of the Panel Report in April 2011. In addition, the Airbus Appellate Body Report in the Airbus case, which was issued on 18 May 2011, reversed many of the Panel’s findings against the EU. Which WTO-inconsistent subsidies did the Dispute Settlement Body find and what is the outlook for the future?

The United States and the European Union have been fighting over aircraft subsidies since 2004. The USA had requested the initiation of WTO dispute settlement proceedings against the EU at the time when Airbus launched the A380 and A350 projects, and when Boeing was about to lose its position as market leader. The EU immediately countersued the USA, resulting in two parallel subsidy cases of a dimension never seen at the WTO. The EU claimed in its filing that Boeing had received over US $19.1 billion in illegal subsidies from state, local and federal sources. The consultations and panel proceedings took more than six years whereas average WTO cases are resolved within approximately 22 months.1 After the decision on Airbus in June 2010, the WTO Panel now ruled that Boeing had received subsidies of at least US $5.3 billion.2 The views on the WTO ruling diverge on both sides of the Atlantic: the USA and the EU both claimed victory.

“This WTO Panel report clearly shows that Boeing has received huge subsidies in the past and continues to receive significant subsidies today. The US began this dispute in 2004 and now finds itself with a crystal clear ruling that exposes its long-running multi-billion dollar subsidisation of Boeing through Federal and State programmes as illegal,” said EU Trade Commissioner Karel De Gucht.3 Although the WTO Panel did not uphold all claims by the European Communities, the Panel estimated the total amount of subsidies received by Boeing4 between 1989 and 2006 to have been at least US $5.3 billion. The 879 pages ruling found that Boeing had received prohibited and actionable subsidies from various sources:

- the US Government through prohibited “Foreign Sales Corporation” export subsidies,
- the NASA and the US Department of Defense through R&D programmes and general support, and
- the States of Washington, Kansas and Illinois through tax breaks and other programmes.

Foreign Sales Corporations

The United States and the European Union had already fought about export-contingent tax benefits for American exporters at the WTO between 1997 and 2006 (“Foreign Sales Corporations” Dispute DS 108).5 Under the Foreign Sales Corporations scheme, US companies were able to receive a reduction in US federal income taxes for profits derived from exports through the use of offshore subsidiaries, so called “Foreign Sales Corporations” (FSC). The WTO ruled that the FSC scheme constituted prohibited

4 In this paper “Boeing” stands for The Boeing Company and the McDonnell Douglas Corporation prior to its merger with Boeing – as applied in the Panel Report.
5 See WTO Dispute DS 108. The Request for Consultations was launched on 18 November 1997, the Panel Report was circulated on 8 October 1999, and the Appellate Body Report was circulated on 24 February 2000. The various Article 21.5 proceedings that followed came to an end with the circulation of the “Second Recourse to Article 21.5 Appellate Body Report” on 13 February 2006. Foreign Sales Corporations date back to a US law provision from 1971 (“Domestic international sales corporations”) and were created under the Tax Reform Act of 1984. The Foreign Sales Corporations scheme had already been challenged under the old GATT regime by the European Communities.

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export-contingent subsidies and requested its withdrawal. The amount of tax advantages through the exclusion of extraterritorial income was tremendous. A WTO Arbitrator’s Award determined in 2002 that the EC would be allowed to raise countervailing duties of up to US $4.04 billion per year. The Foreign Sales Corporation regime and the Extraterritorial Income Exclusion Act of 2000 which replaced it were abolished by the American Jobs Creation Act in late 2004 after the EU had slowly increased countervailing duties. Whether the American Jobs Creation Act was in compliance with the WTO ruling was subject to yet another WTO Panel.

Despite the Panel and the Appellate Body decisions described above, the WTO-incompatible FSC tax reliefs appeared to continue to accrue to Boeing despite their purported “repeal” by the US Congress. In the Boeing case, the Panel concluded that the challenged Foreign Sales Corporations scheme, the Extraterritorial Income Exclusion Act (ETI) and its successor acts constituted prohibited export subsidies under Articles 3.1(a) and 3.2 of the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement). Export subsidies fall into the strictest category under WTO law and are prohibited by any means. The amount of prohibited FSC/ETI subsidies to Boeing’s Large Civil Aircraft (LCA) division was estimated to be US $2.2 billion in the period 1989-2006 (see Table 1).

Most importantly, the Panel found that the United States causes serious prejudice to the interests of the EU. The effects of the FSC/ETI subsidies were significant price suppression, significant lost sales and displacement and impediment of exports from third country markets (with respect to the 100-200 seat single-aisle as well the 300-400 seat wide-body LCA product market). This is important as subsidies have to be “specific” and cause “serious prejudice” in order to be actionable under WTO law.

Nevertheless, the Panel refrained from making any new recommendations regarding the FSC/ETI regimes. The Panel decided that the recommendations of the old Foreign Sales Corporation case DS 108 – i.e. a withdrawal without delay – would remain operative, but that the measures in force at the time of the Panel’s establishment had been changed during the course of the proceedings. The latter reveals a major weakness of WTO law: there is no retroactivity in world trade law and Panel recommendations can be circumvented by modifying the challenged measures during the proceedings (although the subsidisation might still exist in a different, not yet challenged way).

**US Department of Defence and NASA**

Military programmes themselves are not subject to WTO rules, but can provide a temptation to hide subsidies. Finding proof is difficult as new military technologies can be partially used in the large civil aircraft sector, so called “dual-use” technologies. A close link between civil and military aviation results from the fact that the dominant military aircraft manufacturers in both the USA and the EU also dominate the production of civil aircraft. The synergy between the two areas provides for high technological value and economies of scale, since overhead and fixed costs (as they occur in R&D) can be amortised more quickly.

Boeing’s large civil aircraft (LCA) division received support from the US Department of Defence and the National Aeronautics and Space Administration (NASA). NASA, for instance, granted direct financial support as well as access to facilities, equipment and employees through the eight aeronautics R&D programmes. The WTO Panel found that the programmes at issue constituted specific subsidies within the meaning of Articles 1 and 2 SCM, and estimated the amount of the subsidy to Boeing’s LCA division to be US $2.6 billion over the period 1989-2006.

The Department of Defence (DoD) was also found to have provided specific subsidies to Boeing through 23 research, development, testing and evaluation programmes.

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6 According to the Arbitrator, a suspension of concessions under the GATT 1994 in the form of the imposition of a 100 per cent ad valorem charge on imports of certain goods from the United States would constitute appropriate countermeasures within the meaning of Article 4.10 of the SCM Agreement. See WT/DS108/ARB, 30 August 2002.
7 See Request for Consultations by the European Communities, WT/DS317/1.
8 The Panel explicitly included the transition and grandfather provisions of the ETI Act and the American Jobs Creation Act; see WTO Panel Report WT/DS353/R, p. 581.
9 The FSC/ETI measures are inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement. See WTO Panel Report WT/DS353/R, pp. 592 and 781.
11 Within the meaning of Articles 5(c), 6.3(b) and 6.3(c) of the SCM Agreement. See WT/DS353/R, p. 781.
12 The Panel considered it to be well established in WTO dispute settlement practice that when measures have expired, it is appropriate to refrain from making a recommendation. See WTO Panel Report WT/DS353/R, p. 782. In the Panel Report of EC – Approval and Marketing of Biotech Products it was concluded in paragraph 7.1316 that, “WTO jurisprudence supports the inference that panels are to avoid making recommendations which would apply to measures that are no longer in existence or have been amended.”
13 According to the Panel, “it appears that the measure is no longer in force with respect to Boeing”. Cf. WT/DS353/R, p. 782.
15 See WT/DS353/R, p. 487.
Aircraft Subsidies

16 Boeing benefitted from the “dual-use” technologies, i.e. technologies applicable to both military and commercial aircraft. While the Panel did not accept the United States’ estimate that the total amount of any DoD subsidy to Boeing for “dual use” R&D was significantly less than US $308 million over the period 1991-2006, the amount of the subsidy to Boeing’s LCA division remained unclear.17 The EU originally claimed that Boeing benefitted from the RDT&E programmes to the tune of US $2.379 billion.18 Hence, the actual amount should lie between US $308 and 2,379 million.

Not all of the subsidies challenged by the EU were found to be specific, for instance payments that the Department of Commerce (DoC) made to joint ventures and consortia in which Boeing participated through the Advanced Technology Program. These DoC payments and the access to government facilities were found to be subsidies, but not specific subsidies and hence not actionable under WTO law.19 Also, claims were turned down that certain intellectual property rights transfers under NASA and DoD R&D contracts20 and reimbursements for certain Bid and Proposal Program expenses would constitute specific subsidies.21

Overall, the Panel decided that the detected WTO-incompatible NASA and DoD subsidies caused serious prejudice to the interests of the European Communities.22 The effects of the NASA and DoD aeronautics R&D subsidies were significant price suppression, significant lost sales and threat of displacement and impedance of exports from third country markets, with respect to the 200-300 seat wide-body LCA product market. The Panel accordingly recom-

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16 Payments and access to government facilities, equipment and employees were challenged by the EU.
18 See WT/DS353/R, p. 11.
19 See WT/DS353/R, p. 533, 534.
21 See WT/DS353/R, p. 564. The Panel found that the EU had not demonstrated that NASA and the DoD reimburse Boeing for Independent Research and Development/Bid and Proposal Program expenses that relate to the production of Boeing LCA, and therefore failed to establish the existence of the measures that allegedly constitute a specific subsidy under Articles 1 and 2 of the SCM Agreement.
22 Within the meaning of Articles 5(c), 6.3(b) and 6.3(c) of the SCM Agreement. See WT/DS353/R, p. 781.
mended that the United States take appropriate steps to remove the adverse effects or withdraw the subsidy that has resulted in adverse effects to the interests of the EU. Although the United States Trade Representative, Ron Kirk, confirmed the findings of the Panel, the USA appealed the decision on 29 April 2011.

State Benefits

Not only the US Government and Federal Agencies were found to support The Boeing Company, but also the States in which Boeing manufactures its jetliners. The European Union challenged a broad variety of measures in the States of Washington, Kansas, Illinois, and municipalities therein. The Panel turned down part of the claims, but it found WTO-incompatible subsidies worth over US $500 million in the period 1989-2006.26

Regarding the State of Kansas and municipalities therein, the Panel estimated the amount of subsidisation at US $475.8 million. Certain property and sales tax abatements provided to Boeing pursuant to Industrial Revenue Bonds (IRBs) were determined to constitute specific subsidies provided to Boeing pursuant to Industrial Revenue Bonds (IRBs) were determined to constitute specific subsidies within the meaning of Articles 1 and 2 SCM Agreement. Subsidies worth US $11 million were found in the State of Illinois and municipalities therein (see Table 1). Support was provided in consideration of Boeing’s decision to relocate its corporate headquarters to Chicago. WTO-incompatible subsidies included certain reimbursements of Boeing’s relocation expenses to Chicago provided for in the Corporate Headquarters Relocation Act (CHRA), as well as 15-year tax credits, and the abatement or refund of a portion of Boeing’s property taxes provided for in the CHRA.

The State of Washington and municipalities therein were found to subsidise Boeing to the tune of US $77.7 million. Various tax rate reductions, tax credits and tax exemptions had been provided by the State of Washington in 2003 to retain and attract the aerospace industry to Washington State. Most importantly the Washington Business and Occupation (B&O) tax reduction was found to constitute an actionable subsidy. Classified as specific subsidies were also an Employment Resource Center and tax rate reductions adopted by the City of Everett in connection with the location of the 787 assembly facility in Everett. The Panel decided that the Washington B&O tax reductions caused serious prejudice to the European Communities’ interests. It found a displacement of EU exports from third country markets, significant price suppression and significant lost sales. An immediate withdrawal of the measures causing adverse effects was recommended by the Panel.

The WTO’s quantification of the condemned Washington Business and Occupation tax reduction take only subsidies provided until 2006 into account, i.e. the Panel did not take into account any post-2006 subsidy amounts. The value of the benefit to Boeing arising from the Washington B&O tax scheme is quantified by the EU as US $2.12 billion over the period 2006-2024. According to the EU, the overall benefit from the Washington House Bill 2294 (which includes the B&O tax reduction) is estimated to be approximately US $3.56 billion over the period 2004-2024. The EU sees its legal interpretation confirmed as the Panel found adverse effects for the EU and recommended the immediate withdrawal of the measures. The EU expects the USA to withdraw the bill which will grant future benefits of up to US $3.56 billion to Boeing. The United States, of course, deny this view and the issue will be referred to the WTO Appellate Body.

Also contested during the appeal will be the evaluation of “serious prejudice” in the case of the other State subsidies. The Panel did not share the EU’s view that the measures by the States of Kansas, Illinois, and municipalities therein described above would cause serious prejudice through their effects on Boeing’s LCA pricing behaviour. The EU subsequently appealed the Panel’s interpretation of adverse effects.

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28 The Panel also found that the direct transfer of funds following the issuance of Kansas Development Finance Authority Bonds (KDFA bonds) is a financial contribution within the meaning of Article 1 of the SCM Agreement, but that the EU had not demonstrated that the benefit of the financial contribution passed through to Boeing. Therefore, the Panel ruled that the measure did not constitute a subsidy to Boeing. Cf. WT/DS353/R, p. 414.
30 The Panel found the following specific subsidies within the meaning of Article 5 and 6 SCM Agreement in the State of Washington: the Business and Occupation (B&O) tax reduction provided for in the Washington House Bill 2294; B&O tax credits for preproduction development, computer software and hardware and property taxes, the sales and use tax exemptions for computer hardware, peripherals and software; City of Everett B&O tax reduction; and the Workforce Development Programme and Employment Resource Center. See WT/DS353/R, p. 584.
32 Within the meaning of Article 6.3(b) of the SCM Agreement.
33 Within the meaning of Article 6.3(c) of the SCM Agreement and with respect to the 100-200 seat single-aisle and the 300-400 seat wide-body LCA product market. Cf. WT/DS353/R, p. 716.
34 See WT/DS353/R, p. 783.
1992 Bilateral Agreement on Trade in Large Civil Aircraft

With the filing of the suit against the European Union and Airbus in 2004, the USA had also terminated a bilateral agreement on support for European and US aircraft manufacturers. The EU-US “Agreement on Trade in Large Civil Aircraft” (TLCA) of 1992 regulated the permitted levels of state aid for the American and European producers of wide-body civil aircraft. Direct government support was fixed at a maximum of 33% of total development costs, and loans had to be provided with an interest rate covering at least the government’s loan costs. Production subsidies were prohibited. Indirect state aid was limited to a maximum of 3% of the commercial aircraft industry’s annual turnover, or to a maximum of 4% of each company’s turnover in civil aviation. Whether the 1992 TLCA would be applicable in the current Boeing case and whether the EU suffered serious prejudice from violations of the TLCA was not decided by the WTO Panel. The practice of Judicial Economy allows a Panel to refrain from making findings when a measure is inconsistent with various provisions and other findings of inconsistency would suffice to resolve the dispute. The Panel did so and based its Boeing decision on the WTO Agreement on Subsidies and Countervailing Measures.

The WTO Appellate Body went even further and stated in its Appellate Body Report on the Airbus case (DS 316) of 18 May 2011, “that Article 4 of the 1992 Agreement is not a relevant rule of international law applicable in the current Boeing case and whether the EU suffered serious prejudice from violations of the TLCA was not decided by the WTO Panel. The practice of Judicial Economy allows a Panel to refrain from making findings when a measure is inconsistent with various provisions and other findings of inconsistency would suffice to resolve the dispute.” The Panel did so and based its Boeing decision on the WTO Agreement on Subsidies and Countervailing Measures.

Outlook

The views on the Boeing Panel Report diverge substantially on both sides of the Atlantic. The United States and the European Union claimed a “sweeping” victory. Still, both parties appealed parts of the Panel Report in April 2011. The WTO Appellate Body will review the legal interpretations of the Boeing Panel, but will not re-examine existing evidence or examine new issues. A negotiated settlement between the two parties seems unlikely before the Appellate Body Report is issued in the Boeing case, i.e. early 2012. The European Union has signalled its willingness for a negotiated agreement since the beginning of the dispute. The United States, however, declared that a precondition for talks would be an immediate withdrawal of the European Reimbursable Launch Aid programme. The EU has always refused negotiations with unilateral preconditions. Furthermore, the EU sees its legal view on Reimbursable Launch Aid confirmed by the Appellate Body Report in the Airbus case which was issued on 18 May 2011 (DS 316).

This Airbus Appellate Body Report of 18 May 2011 overturned a substantial part of the Panel’s findings. The Panel Report on the Airbus case had been circulated on 30 June 2010. Most importantly, the Reimbursable Launch Aid programme provided by the Airbus consortium states and the European Union was no longer classified as prohibited export subsidies. Reimbursable Launch Aids (RLA) are repayable, low-interest rate loans which were structured according to the provisions of the bilateral TLCA. They covered up to one third of the development costs of a new aircraft model. Part of the RLA was found to be actionable instead of prohibited, but to have caused adverse effects for the United States. The adverse effects and the amount of subsidisation, however, have been calculated neither by the Panel nor by the Appellate Body. In contrast, the Panel in the Boeing case quantified the amount of WTO-incompatible subsidies to be at least US $5.3 billion. This figure does not include the future benefits from the condemned Washington State B&O tax reductions of up to US $3.56 billion (until 2024) and the Department of Defence support which lies between US $308 and 2,379 million.

The Appellate Body also reversed the findings that French Government’s transfer of shares in Dassault Aviation to Aérospatiale conferred a benefit on Aérospatiale. Moreover, various research and technology development (R&T&D) measures that had been included in the Panel Report were now found to have not caused serious prejudice to the USA – e.g. grants under the EC Framework Programmes, R&T&D grants by French government, German grants from the “Luftfahrtforschungsprogramm”, certain grants by Bavarian, Bremen, and Hamburg authorities, civil aircraft research and development and aeronautics research programmes by the UK government and the Spanish PROFIT Programme. The Appellate Body also reversed the Panel’s findings of displacement in Brazil, Mexico, Singapore and Chinese Taipei, and of threat of displacement in India.

38 A precise definition of indirect aid, however, was never supplied.
The EU sees the American legal position weakened after the Boeing Panel Report, which quantified the illegal subsidies at a minimum of US $5.3 billion, and after the Airbus Appellate Body Report, which overturned important parts of the Panel decision in the Airbus case. The American Trade Representative, Ron Kirk, said however, “that the WTO-inconsistent subsidies that the Europeans gave to Airbus dwarf anything that the U.S. government has given to Boeing”. The opposing views seem irreconcilable and will make a negotiated agreement hard to reach. The disputes might even go on after the final Appellate Body Reports with proceedings regarding the implementation of the WTO rulings. These compliance proceedings (under Article 21.5 Dispute Settlement Understanding) can take even longer than the actual panel itself, as for example the Foreign Sales Corporation case showed.

Both aircraft disputes are at a turning point where the EU and the USA have to decide whether to continue the costly trade battle for years or to reach an agreement and focus on the changing market environment. The battle for this market is not surprising, as global airline traffic is expected to more than double by 2029, leading to a demand for up to 25,850 passenger and freight aircraft representing a market value of US $3.2 trillion. It remains a strategic industry as not only the US Congress decision over the US $35 billion Air Force tanker tender showed. New competitors have entered the aviation sector and are being heavily subsidised by their national entities. As the duopoly is at stake in the long run, it seems surprising that the USA does not want to enter into negotiations for a bilateral or multilateral agreement on subsidies in the aviation sector. The USA had always claimed that it did not subsidise Boeing and expected WTO member states to follow WTO rules and not to grant illegal subsidies. This position seems somewhat weakened after the WTO Panel Report on Boeing subsidies. Whether it will lead to a rethinking in the United States and a new agreement in the aviation sector remains uncertain.

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2 See Airbus: Airbus Global Market Forecast 2010-2029, Toulouse 2010. New passenger aircraft deliveries are estimated at 24,980, new freighter aircraft deliveries at 870, leading to total new aircraft deliveries of 25,850.