The WTO Boeing-Airbus dispute (updated 15 June 2007)

The EU WTO challenge to US government subsidies to Boeing

- Following the United States' unjustified and unilateral withdrawal from the 1992 bilateral EU-US Agreement on Trade in Large Civil Aircraft and the initiation of WTO dispute settlement procedures against the EU, the EU for its part on 6 October 2004 decided to mirror the US steps by initiating WTO dispute settlement procedures regarding a number of US measures, including federal and state subsidies. A WTO panel was set up thereafter (for details of the procedure see http://trade.ec.europa.eu/doclib/docs/2006/november/tradoc_129465.pdf - updated regularly).

- The EU has undertaken numerous good faith attempts towards a negotiated solution to the differences of opinion between the EU and the US, without success to date.

- In its WTO case against the US, the EU is challenging various US Federal, State and local subsidies benefiting Boeing, totalling USD 23.7 billion in WTO-inconsistent subsidies over the past two decades and up to 2024.

- At federal level, Boeing benefits from numerous types of R&D support provided by NASA and the Department of Defense (DOD). This support includes contracts for R&D work to be carried out by Boeing (ultimately benefiting Boeing's LCA division and Boeing's aircraft models), reimbursement of Boeing's own R&D expenses, extensive cooperation with NASA and DOD engineers at no cost to Boeing, and use of testing facilities and equipment, also at no cost to Boeing. This support is coupled with the transfer of patents and other vital knowledge to Boeing, and reinforced by stringent restrictions on the application and use of such knowledge by foreign competitors. The EU estimates the benefits of US federal research programs to Boeing at around USD 16.6 billion over the last two decades.

- At federal level Boeing also enjoys significant tax breaks under the Foreign Sales Corporation and successor legislation. That legislation has already been found to constitute prohibited export subsidies by multiple WTO panels and the WTO Appellate Body. The EU estimates these tax benefits at a value to Boeing's LCA division of USD 2.2 billion over the period 1989-2006. A recent official IRS Memorandum suggests that US exporters, including Boeing, would continue to benefit from the illegal tax breaks

even after the end of 2006 which should have marked the end of all benefits under the FSC and successor legislation.

- At the State and local level, illustrative examples of subsidies to Boeing include a USD 4 billion package in the State of Washington (combining tax breaks, tax exemptions or tax credits and infrastructure projects for the exclusive benefit of Boeing) and a USD 900 million package in the State of Kansas in the form of tax breaks and subsidised bonds, some of which are known as "Boeing Bonds". These will be enjoyed by Boeing until 2024.

- The EU will demonstrate before the WTO panel that the lavish subsidies benefiting Boeing has allowed Boeing to engage in aggressive pricing of its aircraft which has caused lost sales, lost market share and price suppression to Airbus on a number of select markets. It will also show that Boeing received illegal export subsidies: in addition to the Foreign Sales Corporation programme, the Washington State package was made contingent upon Boeing's export performance. Finally, the EU will also demonstrate that the US has caused serious prejudice to the EU's interests by violating the EU-US 1992 Agreement.

- The EU remains open to pursuing a negotiated solution. However, the starting point for such negotiations should be realistic, balanced and pragmatic.

The US WTO challenge to EU support for Airbus

- Since 1992 direct and indirect government support to aircraft industry in the US and the EU has been regulated by the bilateral EU-US Agreement on Trade in Large Civil Aircraft. The EU in good faith has continuously met all commitments under this agreement whereas US compliance had been less than adequate, in particular by covering up large hidden subsidies to Boeing including unprecedented prohibited production subsidies in Washington State for the 787 and other Boeing commercial aircraft.

- Nevertheless, during the course of the Summer 2004 the United States purported to unilaterally withdraw from the bilateral 1992 Agreement (a move that the EU considers invalid as it did not respect the required conditions) and unexpectedly filed a WTO challenge of all EU support even though it had been granted in accordance with the Agreement.

- On 6 October 2004 the US requested formal WTO consultations with the EU regarding alleged subsidisation of Airbus by the EU and certain of its Member States, and a WTO panel was set up thereafter (for details of the procedure see http://trade.ec.europa.eu/doclib/docs/2006/november/tradoc_129465.pdf - updated regularly).

- The major bone of contention is that of EU Member State co-financing of R&D for new Airbus aircraft ("Member State Financing" or "reimbursable launch investment"). This form of support is expressly agreed under the bilateral EU-US Agreement and

has been used on three of the nine Airbus aircraft launched since 1990. It provides for government funding to Airbus repaid with interest under terms specified in the Bilateral Agreement (loan rates of return are cost to government plus 1%, and interest and principal is repaid on deliveries, even before the programs break-even). In some cases the terms are more onerous than those commercially available in that the lending governments are receiving royalty payments that will last through the life of a particular aircraft program even though the original loan and interest are completely repaid. In fact, EU governments so far have made handsome returns on their initial "investments", even though there are instances where Airbus has been able to obtain financing on more favourable terms from private lenders, compared with government offers. As of today, Airbus has repaid in excess of 7 billion euros (USD 9 billion). Since 1992, Airbus has repaid 40 percent more than it has received from EU governments. Airbus currently repays loans at the rate of 300 to 400 million euros a year.

- The US is now seeking to argue that the benefit of MSF alone amounts to as much as USD 205 billion and is actively trying to "sell" this vastly exaggerated amount. This "estimate" is completely unrealistic. It is more than 8 times the capitalisation of EADS, USD 25.8 billion, or roughly 12 times the net assets of EADS, USD 18. 4 billion! The US magically reaches this "estimate" by compounding interest on subsidies dating back as far as 1967. This method of calculation is contrary to accepted wisdom, practices and the WTO Subsidies Agreement – the US methodology assumes that subsidies somehow continue in perpetuity and are never amortised.

- If the US methodology were to be applied to the already massive federal, state and local subsidies benefiting Boeing, the amount challenged by the EU would be not USD 23 billion, but rather USD 305 billion! One can only begin to imagine what the US response to an EU claim along those lines would be.

- The US also claims that a number of <u>infrastructure projects</u> were allegedly built or upgraded exclusively for Airbus, or that Airbus enjoyed preferential treatment. However, unlike infrastructure projects in the State of Washington (which were designed for Boeing and for which Boeing benefited from preferential treatment), Airbus pays a market-based rent and clearly did not benefit from any preferential treatment for these projects, or they were for the use of the general public.

- As regards <u>research and technology support</u> in the EU (be it at EU or EU Member State level), such activities are co-financed by the industry and receive no more than a 50 % maximum contribution from the EU or Member States, and the EU abides by the cap provided in the bilateral EU-US agreement for such support. The amounts budgeted by NASA and the Department of Defense for R&D support to Boeing's LCA business are estimated to be 10 times higher. And not a cent of it is repaid.

- The US now seeks to argue that the amount of R&T support is USD 3 billion. The US arrives at the inflated USD 3 billion figure by an exercise of serious "overreach". The US seeks to include grants to "other Airbus companies". Companies which are wholly unconnected to the production of large civil aircraft (EADS, BAE Systems).

The US also seeks to include partners in various collaborative projects and, in the case of France, uses budget estimates rather than actual disbursements.

- The US also argues that Airbus benefited from preferential loans from the European Investment Bank (EIB). The EIB has indeed provided loans to Airbus but it has done so in full conformity with its lending rules and policy on conditions strictly similar to that of loans to other clients. For instance, the EIB has provided loans to European airlines for the purchase of Boeing aircraft, as well as to several other large US companies for investments in the EU.

- The EU remains open to pursuing a negotiated solution provided this time it is binding. However, the starting point for such negotiations should be realistic, balanced and pragmatic.

Some key dates in the WTO process in 2007

9 February 2007 EU files confidential version of First Written Submission in defensive case (DS316)

20/21 March 2007 First hearing in defensive case

22 March 2007 EU files confidential version of First Written Submission in offensive case (DS353) and puts non-confidential version of First Written Submission in defensive case on website

24-26 July 2007 Second hearing defensive case (rebuttals of 25 May)

6 July 2007 US files confidential First Written Submission in offensive case

26-27 September 2007 First hearing offensive case

28 September 2007 EU puts non-confidential version of First Written Submission in offensive case on website

Details of the US subsidies to Boeing challenged by the EU

1. State and Local Subsidies

a. State of Washington: incentive package of measures benefiting the development, production and sales of US LCA[1]. These incentives include but are not limited to tax and other advantages

b. State of Kansas: incentives, including bond financing, tax benefits and other advantages, to the US LCA industry.

c. State of Illinois: incentives, including tax incentives, relocation assistance and other advantages, to the US LCA industry

2. NASA Subsidies

NASA transfers economic resources on terms more favourable than available on the market or not at arm's length to the US LCA industry, *inter alia*, by:

a. allowing the US LCA industry to participate in research programmes, making payments to the US LCA industry under those programmes, or enabling the US LCA industry to exploit the results thereof by means including but not limited to the foregoing or waiving of valuable patent rights, the granting of limited exclusive rights data ("LERD") or otherwise exclusive or early access to data, trade secrets and other knowledge resulting from government funded research.

b. providing the services of NASA employees, facilities, and equipment to support the R&D programmes listed above and paying salaries, personnel costs, and other institutional support, thereby providing valuable services to the US LCA industry on terms more favourable than available on the market or not at arm's length.

c. providing NASA Independent Research & Development, and Bid & Proposal Reimbursements.

d. allowing the US LCA industry to use the research, test and evaluation facilities owned by the US Government, including NASA wind tunnels, in particular the Langley Research Center.

e. entering into procurement contracts with the US LCA industry for more than adequate remuneration.

f. granting the US LCA industry exclusive or early access to data, trade secrets, and other knowledge resulting from government funded research.

[1] Large Civil Aircraft(s)

g. allowing the US LCA industry to exploit the results of government funded research, including, but not limited to, the foregoing or waiving of valuable patent rights or rights in data as such.

3. Department of Defense Subsidies

The Department of Defense ("DOD") transfers economic resources to the US LCA industry on terms more favourable than available on the market or not at arm's length, *inter alia*, by:

a. allowing the US LCA industry to participate in DOD-funded research, making payments to the US LCA industry for such research, or enabling the US LCA industry to exploit the results of such research, by means including but not limited to the foregoing or waiving of valuable patent rights, and the granting of exclusive or early access to data, trade secrets and other knowledge resulting from government funded research.

b. allowing the US LCA industry to use research, test and evaluation facilities owned by the US Government, including the Major Range Test Facility Bases.

c. entering into procurement contracts, including those for the purchase of goods, from the US LCA industry for more than adequate remuneration, including in particular but not limited to the US Air Force contract with Boeing for the purchase of certain spare parts for its Airborne Warning and Control System (AWACS) aircraft, the National Polar-orbiting Operational Environmental Satellite System-Conical Microwave Imager Sensor, the C-22 Replacement Program (C-40), the KC-135 Programmed Depot Maintenance, the C-40 Lease and Purchase Program, the C-130 avionics modernisation upgrade program, the C-17 H22 contract (Boeing BC-17X), the US Navy contract with Boeing for the production and maintenance of 108 civil B-737 and their conversion into long-range submarine hunter Multi-Mission Aircraft, the Missile Defense Agency's Airborne Laser (ABL) Program, and the Army's Comanche Program.

d. by allowing the US LCA industry to exploit the results of government funded research, including, but not limited to, the foregoing or waiving of valuable patent rights or rights in data as such.

4. National Institute of Standards & Technology (US Department of Commerce) Subsidies

The US Department of Commerce ("DOC") transfers economic resources to the US LCA industry on terms more favourable than available on the market or not at arm's length, through the Advanced Technology Program operated pursuant to the Omnibus Trade and Competitiveness Act of 1988, as amended, and the American Technology Preeminence Act of 1991, by allowing the US LCA industry to participate in this programme, making payments to the US LCA industry under this programme, or allowing the US LCA industry to exploit the results of this programme, including but not limited to the foregoing or waiving of valuable patent rights, and the granting of exclusive or early access to data, trade secrets and other knowledge resulting from government funded research.

5. US Department of Labor

The US Department of Labor transfers economic resources to the US LCA industry on terms more favourable than available on the market or not at arm's length, through the Aerospace Industry Initiative, an element of the President's High Growth Training Initiative, under the authority of the Workforce Investment Act, by granting to Edmonds Community College in the State of Washington funds for the training of aerospace industry workers associated with the Boeing 787.

6. Federal tax incentives

The US Government transfers economic resources to the US LCA industry through the federal tax system, and in particular through the following tax measures:

a. Sections 921-927 of the Internal Revenue Code (prior to repeal) and related measures establishing special tax treatment for "Foreign Sales Corporations" ("FSCs");

b. FSC Repeal and Extraterritorial Income Exclusion Act of 2000; and

c. American Jobs Creation Act of 2004.

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