UNITED STATES – MEASURES AFFECTING TRADE IN LARGE CIVIL AIRCRAFT (SECOND COMPLAINT) (DS353)

Executive Summary of the Oral Statement of the United States at the first substantive meeting of the Panel with the parties

1. Under the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"), to prevail on its actionable subsidy claims, the European Communities ("EC") must establish (1) that a specific subsidy or subsidies exist, (2) that one of the conditions listed in Article 6.3 of the SCM Agreement – in this case, displacement or impedance, significant price suppression, or lost sales – has occurred, and (3) that the condition is the "effect of the subsidy." The Appellate Body has found that this last step requires demonstration of a "causal link" between the alleged subsidy and the conditions referenced in Article 6.3, which must ensure that the effects of factors other than any subsidies are not attributed to the subsidies. The EC has not met any of these requirements.

2. **U.S. Department of Defense ("DoD") R&D**. In paying Boeing to conduct research, DoD did not, as the EC claims, get nothing in return for its money. In fact, it obtained valuable technology and information for military purposes. At one point, the EC concedes that this is the case, but claims, contrary to the evidence on the record, that much of the research has "dual uses" that advance Boeing's production of large civil aircraft. However,"dual use" means the adaptation of civil technologies for military usage – not the other way around, as the EC asserts. Second, DoD research focuses on capabilities that are not relevant to civil aircraft. Finally, even if some DoD-funded research had a theoretical applicability to large civil aircraft, U.S. export control laws make use of any resulting technology on large civil aircraft a practical impossibility. Thus, there is no basis to conclude that DoD research was a financial contribution or provided a benefit with regard to Boeing's large civil aircraft. It is also important to note that the EC has greatly exaggerated the magnitude of the programs it challenges.

3. **National Aeronautics and Space Administration ("NASA") R&D.** The EC has also argued that NASA research programs provided grants, and goods and services to Boeing for free. What the EC calls research "grants" were actually NASA purchases of R&D services in furtherance of NASA's own objectives. Therefore, as with DoD's research purchases, these are not financial contributions within the meaning of the SCM Agreement. Similarly, the alleged provision of goods and services were in fact value-for-value exchanges pursuant to Space Act Agreements. Boeing received nothing for free. In both purchases and under Space Act Agreements, NASA focuses on basic, fundamental R&D covering a broad range of aeronautics topics. It does not fund the development of particular products, or promote the interests of particular companies. Thus, it conveys no commercial advantage and no financial contribution. In addition, the EC greatly exaggerates the value of any NASA payments to Boeing.

4. **IR&D/B&P.** The independent research and development ("IR&D") and benefit and proposal ("B&P") reimbursements by DoD and NASA are not separate payments to contractors. They are indirect costs or "overheads", which are normal costs of doing business incurred by a company, but not related to particular transactions. The government must cover these sorts of costs in the prices it pays, or commercial suppliers will not do business with it. Thus, there is no benefit and no specificity.

5. **Intellectual property rights under DoD and NASA contracts.** The treatment that the EC challenges arises only when a private party enters a contract with the U.S. government, and thus is part of the overall deal between an agency and its contractor. Further, under U.S. law, patent rights accrue to the inventor. The intellectual property clauses in a government contract confer certain rights on the government, not the contractor, to use inventions or data conceived by the contractor during performance of the contract. These rights are an important part of what the government obtains under its R&D contracts. The rights retained by contractors are not given for free, but are part of an overall commercial transaction.

6. **FSC/ETI**. The critical facts on this topic are not in dispute. The United States does not contest that FSC/ETI was an export subsidy. The EC does not contest that Boeing has stated that it will not use that subsidy after the 2006 tax year. Instead, the EC focuses on a memorandum issued by the an Associate Chief Counsel of the U.S. Internal Revenue Service with regard to the eligibility for FSC/ETI benefits in some circumstances. As evidence, that general evaluation should not supersede the conclusion reached by Boeing with regard to its specific tax situation that it will not use that subsidy in the future. In addition, the EC has disregarded that the memorandum itself states that "{t}his advice may not be used or cited as precedent."

7. **Advanced Technology Program.** Under the Advanced Technology Program, the Department of Commerce makes grants to a wide swath of U.S. industries. Therefore, this program is not specific and not an actionable subsidy.

8. **Washington state tax measures.** The effect of the Washington state Business and Occupation ("B&O") tax adjustment is to bring the tax rate for aerospace manufacturing into line with the average tax rate for all business activities in the state of Washington. Without the adjustment, the effective tax rate on aerospace manufacturing is significantly higher than other business activities in the state, because of pyramiding. Since the B&O tax rate does not confer a preferential rate on Boeing, the state is not foregoing revenue that would otherwise be due. Thus, there is no financial contribution. The EC's claim fails on this basis alone. However, even if the Panel were to find that there is a financial contribution, the B&O tax adjustment is not specific to an industry or enterprise because several industries in Washington state also receive a B&O tax adjustment. The EC also raises challenges to other Washington state tax measures; however, in none of these cases does the EC establish that subsidization exists.

9. **Washington state infrastructure.** The EC also challenges Washington state's expansion of two public roads, as part of a statewide infrastructure improvement plan as subsidies. However, these projects are quintessential general infrastructure, which are explicitly excluded from the SCM Agreement's disciplines.

10. **City of Wichita Industrial Revenue Bonds ("IRBs").** First, the Industrial Revenue Bonds issued by the state of Kansas neither provide a financial contribution to Boeing nor are specific to Boeing. The EC claims that Kansas' IRB program is merely a scheme to make Boeing eligible for certain tax abatements. However, the tax exemptions are no longer relevant to Boeing because Kansas has stopped assessing property tax and sales tax on commercial and industrial machinery and equipment, which comprises the vast majority of property that Boeing has financed with IRBs are machinery and equipment. Furthermore, the IRBs are not *de jure*

specific because they are broadly available to "any person, firm or corporation." IRBs are also not *de facto* specific because in light of the "extent of diversification of economic activities" within Wichita, the amount of IRBs issued to Boeing is not indicative of predominant use.

11. **Kansas Development Finance Authority bonds.** Not a single bond under this program has even been issued to Boeing. Instead, these bonds were issued to an independent entity, unrelated to Boeing.

12. **Illinois programs.** With respect to the EC challenges to measures by the state of Illinois, the EC fails to establish that these measures are specific. The state of Illinois has established criteria to encourage businesses to locate their corporate headquarters in the state. These criteria are not specific to an industry or enterprise. Thus, they do not constitute an actionable subsidy under the SCM Agreement.

13. **Export contingency.** As a final point on the EC's subsidy allegations, the Panel should note that there is no evidence to support the assertion that the Washington state tax measures under HB 2294 were export-contingent subsidies. The measure challenged by the EC was to become effective upon the state and "a manufacturer of commercial airplanes" signing "a memorandum of agreement regarding an affirmative final decision to site a significant commercial airplane final assembly facility in Washington state." However, the measure, HB 2294, does not require that 36 airplanes per year actually be produced; it simply requires that the assembly facility have the capacity to do so.

14. **Financial contributions to companies other than Boeing**. A flaw permeating the EC's claims is the EC's treatment of financial contributions to Boeing's suppliers as payments to Boeing based on the assertion, without support of any credible evidence, that these independent and unrelated companies somehow (and contrary to expectations for a profit-maximizing actor) passed the alleged subsidies through to Boeing.

15. **DSU Article 13**. With respect to the EC's statement regarding Article 13 of the DSU, as an initial point, the United States sees no relevance to the EC's assertion regarding the Annex V process in DS317. Additionally, the EC has provided no basis for the Panel to conclude that the information it seeks is necessary to understand or evaluate the evidence or arguments presented by the parties. Finally, the very format of the questions posed by the EC seems to miss the point of Article 13. The EC is not seeking "information" directed to addressing an argument made by the EC or the United States. It is, instead, listing generic categories of documents, without regard as to whether they contain information of the type sought by the EC.

16. **Adverse effects.** The arguments that alleged U.S. subsidies caused adverse effects to EC interests ignore a critical fact – that Airbus and its aircraft are doing quite well. Airbus has gained 20 percentage points in market share since 2000. It tells the industry that its performance in 2006 was the "best" and "highest" in critical respects, and that 2007 is even better. To be sure, Airbus has experienced some problems, among them difficulties with its A380 and A350, but even Airbus admits that these have nothing to do with the alleged subsidies. And the situation continues to improve. The A380, the largest civil aircraft ever, is scheduled to enter commercial service next month. Last December, Airbus unveiled the final design of its A350,

labeled the A350 XWB, with innovative technologies that it promises will give customers unprecedented cost savings.

17. The EC instead asserts that, in spite of this impressive performance, the alleged subsidies caused serious prejudice to Airbus in the form of price suppression, lost sales, and market displacement/impedance.

18. The EC, however, has failed to establish the existence of any of the Article 6.3 conditions. With regard to displacement/impedance under Article 6.3(a) and (b), the EC has framed its analysis in terms of orders, which do not indicate the "imports" or "exports" covered by those Articles. Moreover, the countries the EC identifies as "third country markets" had only small and sporadic deliveries, such that they do not allow for any meaningful conclusions under Article 6.3(b). As for price suppression, outside factors like Airbus' missteps in launching the A350, the unattractiveness of the A340 in a high fuel cost environment, and Airbus undercutting of Boeing prices in major A320 campaigns leave no reason to expect Airbus' prices to have increased more than they actually did. With regard to lost sales, the evidence demonstrates that factors other than the alleged subsidies explain Boeing's success in the sales campaigns identified by the EC.

19. The EC also fails when it comes to the requirement of establishing a causal link between the existence of the Article 6.3 conditions that it asserts and the alleged subsidies. It makes three basic arguments in this regard, but all of them are invalid.

20. First, the EC claims that the magnitude of the alleged subsidies is so great that they must have caused serious prejudice. However, as have discussed, the EC's calculations grossly exaggerate the value of the alleged financial contributions and any benefit they could conceivably have conveyed to Boeing.

21. Second, the EC claims that the nature of the alleged subsidies caused Boeing to lower its large civil aircraft prices below what they otherwise would have been and gave Boeing a technology advantage in developing the 787 that it would not otherwise have had. It argues that these effects in turn caused price suppression, lost sales, and displacement or impedance. However, the EC has misunderstood the nature of the programs it attacks – they do not increase non-operating cash flow. This error by itself should end the analysis. But the EC then makes another error – asserting that increases in non-operating cash flow would lead a company like Boeing to change its pricing practices. It is the market, and not changes in cash flow, that determine Boeing's prices.

22. The only support the EC offers for concluding that cash flow affects Boeing's prices is a series of propositions set out in the Cabral Report, but these are deeply and fundamentally flawed.

- In explaining how alleged subsidy payments affect Boeing, the EC assumes that Boeing spends any additional cash flow in only two ways – making payments to shareholders and using the cash to reduce its prices. The EC disregards readily available public data showing the variety of uses to which Boeing applies its free

cash flow, and aggressive pricing is not one of them. In fact, Boeing can and does spend its money in a number of ways that have no effect on prices.

- The EC then assumes that Boeing has constrained access to capital, when in fact it has available sources of internal capital and faced no significant capital constraints during the relevant period.

- The EC then assumes that its theoretical model accurately depicts how Boeing's pricing practices would be affected by additional cash flow from the alleged subsidies, while ignoring the actual evidence of Boeing's market behavior, which is the opposite of what the theoretical model would predict.

23. The EC also asserts that the "nature" of the subsidies gives rise to "technology effects" on the 787. The EC has provided no basis to conclude that in the absence of the alleged subsidies, Boeing would have developed the 787 later than it did or differently than it did. In fact, the NASA research at issue was widely available, the composites technologies that Boeing built upon to develop the 787 were available in the commercial marketplace, and Airbus was a leader in composites technology at the time it chose to pursue the A380.

24. Third, the EC purports to have calculated with precision how the alleged subsidies collectively reduced the prices charged by Boeing on particular transactions. These calculations are, however, the product of Professor Cabral's economic model, which accepts as given the EC's exaggerated calculation of the magnitude of alleged subsidies and the erroneous propositions noted above. Professor Cabral's reliance on invalid data and an invalid methodology necessarily lead to invalid results.

25. At the same time, the EC ignores the "other factors" that are responsible for the problems Airbus has encountered in the market in the past year or two. By devoting its engineering and other resources to the A380, Airbus precluded itself from devoting those resources to development of a smaller fuel-efficient competitor to Boeing's 787, which proved to be more popular than Airbus ever imagined. And, its choice of a relatively fuel-inefficient design for the A340 created the problems Airbus now faces in marketing that aircraft in today's high fuel price environment. And finally, by systematically undercutting Boeing's prices, Airbus has set pricing expectations in the marketplace at a level that is lower than would otherwise have been the case. These choices are the true source of any difficulties Airbus now faces, and they have nothing to do with the alleged subsidies.