

Subsidy Discipline in the Time of Bailouts

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In early September 2009, as the WTO dispute settlement panel hearing U.S. claims against subsidies provided to Airbus² was about to issue its interim report, many wondered whether the significance of the dispute had not been overtaken by events.³ The Airbus and Boeing disputes have been called the largest and most complex disputes ever brought to the WTO. Yet the magnitude of the subsidies involved – for example, around \$15 billion in launch aid to Airbus, at least in nominal terms, over a period of decades – can sound small when compared to the sums at issue in recent government interventions occasioned by the current financial crisis. As Gary Hufbauer and his co-authors point out, the United States provided “\$285 billion in government guarantees for Citigroup during the month of November 2008 alone.”⁴ In that light, can one really feel passionate outrage over the “mere” three or four billion Euros of launch aid that European governments appear to be ready to provide Airbus for the new A350-XWB, or the “mere” three billion dollars of alleged tax savings Boeing is expected to

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² *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, DS316 (EU – Airbus). With the entry into force of the Treaty of Lisbon on December 1, 2009, the “European Communities” (EC) are now referred to in the WTO as the European Union (EU).

³ E.g., Nicola Clark, “Five-Year Dispute on Aircraft Claims Loses Its Urgency,” N.Y. Times, Sept. 3, 2009, available at <http://www.nytimes.com/2009/09/04/business/global/04wto.html> (“While the findings may be a watershed in a case that, by many measures, is the largest and most expensive to be heard by the global trade body, analysts say the dispute’s relevance has faded . . .”).

⁴ Gary Hufbauer, Luca Rubini, and Yee Wong, “Swamped by Subsidies: Averting a US-EU Trade War After the Great Crisis,” Policy Note, Aug. 4, 2009, available at http://www.insidetrade.com/secure/pdf13/wto2009_3670a.pdf, at 4 (subscription required).

receive over the next two decades in Washington state tax reductions? In a time of massive bailouts, do subsidy disciplines still matter?

1. The Relationship Between the Magnitude of a Subsidy and Its Effects on Trade

(a) The Magnitude and Effect of the Subsidy in CVD and Serious Prejudice Cases

Subsidy lawyers are very familiar with procedures for quantifying the amount of a subsidy benefit in a countervailing duty (CVD) proceeding. The WTO *Agreement on Subsidies and Countervailing Measures* (SCM Agreement) sets forth in Article 14 several general principles for the calculation of the subsidy benefit in a CVD proceeding, and provides in Article 19.4 that a CVD may not be imposed in excess of the amount of the subsidy benefit found to exist. The U.S. Department of Commerce has promulgated detailed regulations governing the calculation of the amount of the benefit from a subsidy and the allocation of that benefit to particular products, producers, and time periods.⁵ However, a CVD is not imposed because the subsidy itself is shown to have trade effects, but rather because subsidized merchandise has been found to cause material injury (or threat of material injury) to the domestic industry.⁶

In fact, whether a subsidy has trade effects is not, in itself, a factor for determining whether a subsidy exists for purposes of the CVD law.⁷ The WTO Appellate Body has

⁵ 19 C.F.R. §§ 351.503-351.527 (2009).

⁶ 19 U.S.C. § 1671(a) (2006).

⁷ *Id.* § 1677(5)(C) (2006) (“The administering authority is not required to consider the effect of the subsidy in determining whether a subsidy exists under this paragraph.”). However, the specificity test can serve to distinguish between subsidies that are generally available – and therefore unlikely to distort investment, production, or pricing decisions – and those that are “specific” to a small enough segment of the economy such that a special advantage is conferred on particular recipients. The specificity test originally evolved as a tool for distinguishing subsidies that should be subject to discipline under the CVD laws and those that should not. *E.g.*, *Cabot Corp v. United States*, 620 F. Supp. 722, 732 n.8 (Ct. Int’l Trade 1985) (“A public good provided by government benefits society in a collective manner. It is not conferred upon any specific enterprise or industry. . . . Each program must therefore be examined

confirmed that, if it is shown that subsidized imports are causing material injury, it is not also necessary to examine “whether, absent the subsidies, the product would have been exported in the same volumes or at the same prices.”⁸ Conversely, it is well established that even a subsidy that has harmful trade effects (for example, it causes significant price suppression in the world market for a product) cannot be countervailed, if the subsidized imports do not cause material injury. This is due to the nature of the CVD remedy itself – if the effect of the subsidy is to reduce world prices for a good, a CVD against imports of the subsidizing country will not remedy the harm, if imports from third countries are available at the depressed world price.⁹

In these situations, the adverse effects provisions of the SCM Agreement may provide relief to a WTO Member that suffers from the trade effects of another Member’s subsidy.¹⁰ For example, Article 6.3(c) provides that significant price suppression is a form of serious prejudice, and Article 5(c) prohibits Members from providing (specific) subsidies that cause serious prejudice to the interests of other Members. However, in a serious prejudice dispute – unlike a CVD case – the remedy available to the complaining Member, at least initially, is a recommendation from the Dispute Settlement Body (DSB) that the subsidizing Member “take appropriate steps to remove the adverse effects or . . . withdraw the subsidy.”¹¹ No issue of

on a case-by-case basis to determine if the benefit accrues to specific beneficiaries or generally to society.”).

⁸ Appellate Body Report, *Japan – Countervailing Duties on Dynamic Random Access Memories from Korea*, WT/DS336/AB/R, para. 265 (adopted Dec. 17, 2007).

⁹ GATT 1947 Panel Report, *Canadian Countervailing Duties on Grain Corn from the United States*, SCM/140, GATT B.I.S.D. 39S/411, paras. 5.2.9-5.2.10 (adopted Mar. 26, 1992) (“*Grain Corn*”).

¹⁰ SCM Agreement, arts. 5-7. Note that the GATT 1947 panel in *Grain Corn*, which was decided under the 1979 Tokyo Round Subsidies Code rather than the SCM Agreement, expressly pointed out the availability of the Subsidies Code provisions on adverse effects in that case. *Grain Corn*, para. 5.2.10.

¹¹ SCM Agreement, art. 7.8.

quantification arises unless and until the subsidizing Member fails to comply with the DSB recommendations and the complaining Member seeks authorization to take countermeasures – and even then, the countermeasures must be “commensurate with the degree and nature of the adverse effects determined to exist,” not the amount of the benefit.¹² Thus, the recent decision of the arbitrator in the *US – Cotton Subsidies* dispute based the amount of countermeasures that Brazil could impose in relation to the significant price suppression in the world cotton market determined to exist in that dispute as a result of U.S. countercyclical and marketing loan payments for cotton on “the impact *on Brazil* of the price suppression resulting from the granting of” these subsidies¹³ – not the amount of the benefit actually provided.

Thus, in serious prejudice cases, the magnitude of the benefit is not directly relevant to determining the subsidy’s trade effects. Of course, as the Appellate Body pointed out in the *Cotton* dispute, one would expect that – all else being equal – a larger subsidy will have greater effects than a smaller subsidy, but the nature of the subsidy matters as well:

Beginning with the text of Article 6.3(c), we note that this provision does not state explicitly that a panel needs to quantify the amount of the challenged subsidy. However, in assessing whether “the effect of the subsidy is . . . significant price suppression,” and ultimately serious prejudice, a panel will need to consider the effects of the subsidy on prices. The magnitude of the subsidy is an important factor in this analysis. A large subsidy that is closely linked to prices of the relevant product is likely to have a greater impact on prices than a small subsidy that is less closely linked to prices. All other things being equal, the smaller the subsidy for a given product, the smaller the degree to which it will affect the costs or revenue of the recipient, and the smaller its likely impact on the prices charged by the recipient for the product. However, the size of a subsidy is only one of the factors that may be relevant to the determination of the effects of a challenged

¹² SCM Agreement, art. 7.9.

¹³ Decision of the Arbitrator, *United States – Subsidies on Upland Cotton (Recourse to Arbitration by the United States Under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement)*, WT/DS267/ARB/2, para. 4.92 (circulated Aug. 31, 2009) (emphasis in original).

subsidy. A panel needs to assess the effect of the subsidy taking into account all relevant factors.¹⁴

Thus, for example, the panel in *Cotton* found that “direct payments” and “production flexibility contract” payments to U.S. cotton producers, as well as crop insurance subsidies, were not dependent on price, and therefore did not contribute to the serious prejudice found to exist.¹⁵

Thus, existing subsidy disciplines take into account more factors than simply the magnitude of the subsidy. In particular, in the serious prejudice context, WTO panels and the Appellate Body have recognized that the nature of the subsidy, not just its magnitude, is an essential part of determining its effects.

(b) The Parties’ Arguments on the Magnitude of the Subsidy Benefit in the *Airbus* and *Boeing* Disputes

The arguments of the parties in the ongoing *EU – Airbus* and *US – Boeing*¹⁶ disputes provide an excellent illustration of the ways in which the magnitude of the benefit is relevant – and not relevant – to a determination of the effects of the subsidy.¹⁷

The principal subsidy at issue in the *EU – Airbus* dispute is “launch aid” that EU member State governments have provided to Airbus on the occasion of the launch of each major new Airbus aircraft model. When an aircraft producer introduces a new aircraft model – such as the Airbus A380 superjumbo or the Boeing 787 Dreamliner – the initial development costs that are expended before a single aircraft is delivered (and paid for) are typically in the range of \$10-15

¹⁴ Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, para. 461 (adopted Mar. 21, 2005) (footnote omitted).

¹⁵ Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/R, paras. 7.1305-7.1307 (adopted, as modified by the Appellate Body, Mar. 21, 2005).

¹⁶ *United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, WT/DS353 (“*US – Boeing*”).

¹⁷ The descriptions of the arguments of the parties in these disputes contained in this paper are taken exclusively from the publicly released submissions of the parties.

billion. These costs are incurred years, even decades, before they can be fully repaid through sales, assuming that the model is successful. And the total investment can approach the entire value of the company – EADS, the parent company of Airbus, has a market capitalization of less than \$20 billion. To launch a new aircraft model is, in essence, to “bet the company” on a project, the success or failure of which will not be determined for years to come.¹⁸

The “launch aid” challenged by the United States are loans provided to Airbus by EU member States that fund a significant portion of these launch costs. The loans are repayable through royalties on each sale of the aircraft. If the aircraft project is successful and sales are high, the loan is effectively repaid with interest – albeit, relatively low interest rates, especially in light of the risk of program failure. If the project is not successful, however, any unpaid balance on the loan is essentially forgiven. Thus, as the British economist Kim Kaivanto writes, “Launch Aid commits European governments to absorbing much of any possible losses, so even if Airbus is risk averse, it has little incentive not to adopt a risky, aggressive strategy.”¹⁹

By contrast, the largest alleged subsidies in the *US – Boeing* dispute are research and development contracts that the U.S. Department of Defense (DOD) and the National Aeronautics and Space Administration (NASA) have provided to Boeing and – when it was still a separate company – McDonnell Douglas. Under these contracts, NASA and DOD hire private companies – including Boeing and, in the past McDonnell Douglas – to perform aeronautics research on topics relevant to the missions of these agencies. These topics may, at a relatively high level of generality, also have applications for civil aircraft design, in addition to the research agenda

¹⁸ U.S. First Written Submission in *EU – Airbus*, Nov. 15, 2006, para. 714, available at http://www.ustr.gov/webfm_send/816.

¹⁹ Kim Kaivanto, “Premise and Practice of U.K. Launch Aid,” *Journal of World Trade* (June 2006), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=739719.

being pursued by NASA or DOD. According to the EU, however, the formal structure of these contracts as government purchases of services is, in essence, a “sham” – in substance, the contracts are really grants to support the research activities of the U.S. civil aircraft producers.²⁰

Both the United States and the EU contend that the subsidies provided by the other to its large civil aircraft industry cause serious prejudice to their own industries. Interestingly, none of the principal subsidies challenged in the disputes are production subsidies, in that they are not conferred directly based on the number of units produced, sold, or exported.²¹ Economics 101 teaches that, all else being equal, price is set at the margin – and thus, a subsidy that does not affect the marginal cost of producing, or increase the marginal revenue of selling, the next unit of production would not be expected to affect price or output. Thus, any claim of serious prejudice in these disputes will require a specific theory as to how the subsidies at issue do affect the relevant markets. The theories advanced by the United States and the EU, as complaining and defending parties in the two disputes, are radically different – and the magnitude of the subsidy plays a very different role in these theories.

²⁰ EC Oral Statement at the First Meeting of the Panel in *US – Boeing*, Sept. 26, 2007, paras. 69-70, available at http://trade.ec.europa.eu/doclib/docs/2007/october/tradoc_136488.pdf.

²¹ The United States argued that some, but not all, provisions of launch aid were made based on expectations of repayment that only could have been fulfilled by Airbus exports, and therefore the provision of the launch aid itself was *de facto* contingent on exports and thus a prohibited export subsidy. U.S. First Written Submission in *EU – Airbus*, Nov. 15, 2006, paras. 343-386, available at http://www.ustr.gov/webfm_send/816. The EU responded that launch aid cannot be an export subsidy when the event that occurs upon an export sale – or in fact any sale – is the *repayment* of the loan, not an additional benefit. EC Oral Statement at the First Meeting of the Panel in *US – Boeing*, Mar. 20, 2007, para. 77, available at http://trade.ec.europa.eu/doclib/docs/2007/march/tradoc_133827.pdf. According to the EU, if the U.S. standard for *de facto* export contingency were adopted, then Washington state tax benefits – allegedly provided in return for Boeing’s establishment of certain 777 Dreamliner production facilities in that state for – would also qualify as export subsidies. EC First Written Submission in *US – Boeing*, July 11, 2007, paras. 991-993, available at http://trade.ec.europa.eu/doclib/docs/2007/september/tradoc_136101.pdf. Thus, both sides’ allegations of prohibited export subsidies, like their allegations of subsidies causing serious prejudice, do not depend on allegations that a subsidy is bestowed on the export (or production or sale) of individual units.

In *EU – Airbus*, the United States first attempted to establish that launch aid was a *sine qua non* for the actual launch decision made by Airbus for virtually all of its aircraft models. The EU member States, through launch aid, accept much of the commercial risk of an aircraft launch decision, while charging effective interest rates that do not reflect that risk. Thus, the United States argued, similar financing would not have been available from the market, except at interest rates at which the projects would not have been viable. Thus, “but for” the subsidy, the Airbus model would not have been launched – at least not at the time, and in the way, that it was launched.²² The EU contested this for the more recent Airbus models, but did not seriously attempt to show that the earlier Airbus launches – accounting for the basic models of almost every Airbus aircraft ever delivered – could have occurred without launch aid.²³ In this view, the magnitude of the subsidy benefit is almost irrelevant – as long as the subsidy is large enough to make the project commercially viable when it was otherwise not viable, it does not matter how large the subsidy is.²⁴

The U.S. argument then turned to the effect of the launch of Airbus models on the large civil aircraft market. Given the strategic considerations in this market, the effect of product launches on the launch decisions of competitors, as well as their sales and profits, can be enormous. A 1995 economic simulation study by Damien Neven and Paul Seabright – funded by the U.K. Department of Trade and Industry, one of the governments that provided launch aid

²² U.S. First Written Submission in *EU – Airbus*, Nov. 15, 2006, paras. 813-819, available at http://www.ustr.gov/webfm_send/816.

²³ U.S. Second Written Submission in *EU – Airbus*, June 28, 2007, para. 575, available at http://www.ustr.gov/webfm_send/817.

²⁴ *Id.*, para. 602 (“Thus, the serious prejudice analysis does not call for a quantification of the subsidy benefit, but for a consideration of whether the magnitude of the subsidy is large enough to be the cause of the effects demonstrated by the United States.”).

– found that the entry of Airbus into the large civil aircraft market “reduces Boeing’s profits by at least \$100 [billion] and McDonnell Douglas’s by two-thirds.”²⁵ Provided that the entrance of Airbus into the market could not have occurred without subsidies – a point that the EU did not seriously dispute – all of these effects can be attributed to the subsidies.²⁶

A significant portion of the EU defense against these claims was to attempt to quantify the subsidy benefit under CVD-like rules. The EU conceptualized the subsidy as if it were a grant on the date of the launch of the relevant model, which it then allocated to sales of only that aircraft model over a fixed period.²⁷ Setting aside the problematic details of the EU calculation,²⁸ the EU defense is largely based on a minimalist quantification of the subsidy benefit. If the benefit is relatively small, the EU reasoned, how could the subsidy cause the large effects claimed by the United States?

The United States consistently declined, in the course of the panel proceedings, to produce its own estimate of the total subsidy benefit at issue. In fact, reducing the benefit to a single number raises a number of complex methodological questions, given the long-term, success-dependent character of the launch aid loans. However, a focus on the amount of the benefit – whether relatively large or small – was ultimately not relevant to the causation theory

²⁵ Damien Neven & Paul Seabright, *European Industrial Policy: The Airbus Case* (1995) at 3, available at <http://www.hec.unil.ch/deep/textes/9509.pdf>.

²⁶ The United States also argued that, in more recent years, Airbus would not have had sufficient capital to engage in certain aggressive pricing behavior if it were simultaneously funding all of its various launch projects without subsidized government loans.

²⁷ EC First Written Submission in *EU – Airbus*, Apr. 5, 2007, para. 1589, available at http://trade.ec.europa.eu/doclib/docs/2007/april/tradoc_134551.pdf.

²⁸ Conveniently, most of the benefits had – on the EU’s view – already been fully expensed prior to the panel’s period of investigation (whether the loans had actually been repaid or not) or else were attributed to the A380 superjumbo, which the EU said did not compete with any U.S. like product and so were irrelevant to a serious prejudice analysis. See U.S. Answers to First Panel Questions in *EU – Airbus*, July 6, 2007, paras. 251-257, available at http://www.ustr.gov/webfm_send/823.

that the United States proposed. If the subsidy was large enough to materially affect the outcome of the Airbus launch decision, the United States argued, then it had met its burden of proof to sustain a claim of serious prejudice.

In the *US – Boeing* dispute, by contrast, it was more difficult for the EU to credibly argue that Boeing’s product development or pricing behavior would have been different “but for” the alleged subsidies. Even if Boeing learned technologies useful for civil aircraft development while performing the research it conducted under its DOD and NASA contracts, it would not necessarily follow that Boeing would not have funded the necessary research on its own – or that any such learning effects were the result of the *subsidy* element of the program (i.e., any excessive remuneration paid by the U.S. agencies, over and above the value of the services provided by Boeing).²⁹ Further, since the provision of any benefit under the NASA and DOD programs would not be tied to Boeing’s civil aircraft production, why would Boeing use any such benefits to lower its aircraft prices more than it otherwise would in order to obtain sales, rather than invest in some other business or return additional profits to shareholders? Unlike launch aid, which is provided on condition that Airbus take a particular action (i.e., launch an aircraft model), the research subsidies alleged by the EU are several steps removed from the actual production and sales of Boeing aircraft.

Thus, in contrast to the *EU – Airbus* dispute, both sides in the *US – Boeing* dispute have devoted considerable attention to the measurement of the subsidy benefit. This is because the theory of causation advanced by the EU – as the complaining party bearing the burden of proof of serious prejudice – depends on the subsidy benefit being large enough to affect Boeing’s

²⁹ In addition, if these research contracts are correctly classified as the government purchase of services, it is unclear whether a government purchase of services – as opposed to goods – for more than adequate remuneration falls within the definition of a financial contribution within the meaning of Article 1.1(a) of the SCM Agreement.

commercial behavior, notwithstanding the lack of any direct tie between the provision of the subsidy and Boeing's actions.³⁰

In sum, the size of the benefit – both in absolute terms and relative to other subsidies and bailouts that may be provided in other industries or sectors – is only one of the factors to be considered in determining the effects of a subsidy. Since it is the effects of the subsidy – or the lack thereof – that presumably justify whether disciplines should be placed on a subsidy, the aircraft disputes illustrate why the impact of a subsidy cannot be analyzed solely on the basis of the dollar values at issue.

(c) The Effects of U.S. Agricultural Subsidies

It is well known that one of the main issues in the often-delayed Doha Development Agenda (DDA) negotiations is the imposition of additional disciplines on agricultural subsidies, especially U.S. agricultural subsidies. The massive size of the U.S. Farm Bill – running to the hundreds of billions of dollars over several years – is often cited as sufficient proof of the excesses of these subsidies. However, as in the aircraft disputes, a closer look at the nature and effects of the subsidies shows that the dollar value of the Farm Bill is only part of the story.

As an initial matter, the largest component of reported U.S. “agricultural subsidies” is in fact assistance to food purchasers – food stamps, school lunches, and the like. The most recent U.S. WTO domestic support notification reports \$87.3 billion in total annual support, of which \$54.2 billion is “domestic food aid.”³¹ Presumably these subsidies are not the focus of international complaints about the Farm Bill.

³⁰ The most recent U.S. and EU submissions on this point are discussed in “WTO Panel in Boeing Case Signals Interest in Following Cotton Case Method,” *Inside U.S. Trade*, Dec. 11, 2009.

³¹ WTO Document G/AG/N/USA/66 (Jan. 19, 2009). Support is divided into “green box” outlays of \$76.035 billion (including \$54.177 billion of domestic food aid), “product-specific” amber box support of \$7.913 billion (of which \$7.742 billion counts towards the U.S. Aggregate Measurement of Support

With regard to true support to agriculture, it is also noteworthy that worldwide CVD investigations of U.S. farm subsidies have failed to find material injury to competing farmers in importing countries. Investigating authorities have found that price declines and other indicators of injury for producers of agricultural commodities in their markets cannot be attributed to the presence of U.S. imports, even when those products are subsidized.³² And, although WTO panels and the Appellate Body have repeatedly found that U.S. cotton subsidies increase U.S. cotton production and therefore depress or suppress world cotton prices, further challenges to other U.S. agricultural subsidies have not been forthcoming.

Indeed, even critical studies of U.S. agricultural subsidies find that subsidies actually have a significant effect on U.S. production levels for only a few agricultural commodities. For example, a 2006 study by the Australian Bureau of Agricultural Resource Economics (ABARE) examined the effect of the complete elimination of all U.S. agricultural subsidies and import tariffs on U.S. long-term agricultural production levels.³³ For the five major “program crops”

(AMS)), and “non-product-specific” amber box support of \$3.430 billion. *Id.* The U.S. annual AMS limit is \$19.103 billion. *Id.*

³² See Canadian International Trade Tribunal, *Unprocessed Grain Corn Originating in or Exported from the United States of America*, Inq. NQ-2005-001, May 3, 2006, para. 106 (concluding that “the decline in the selling prices of domestic grain corn is essentially attributable to the appreciation of the Canadian dollar and other factors unrelated to” imports of U.S. corn), available at ftp://ftp.citt-tcce.gc.ca/doc/english/Dumping/Inquiries/Findings_Reasons/nq2f001_e.pdf, *aff’d*, *Ontario Corn Producers Ass’n v. Canadian Pork Council*, 2007 FCA 216 (Fed. Ct. App.); Comisión de Fiscalización de Dumping y Subsidios (Peru), Res. No. 061-2009/CFD-INDECOPI, Apr. 20, 2009, at 19 (concluding that “the material injury suffered by the domestic [cotton] industry is fundamentally explained by the significant increase in production costs, such that if these factors had not been present, the domestic industry would not have suffered a material injury with respect to profitability, even with the presence of subsidized imports [of U.S. cotton] in the national market”), available at http://www.indecopi.gob.pe/RepositorioAPS/0/5/par/RES_061_2009_CFD/Res061-2009CFD.pdf.

³³ ABARE, *U.S. Agriculture Without Farm Support*, Sept. 2006, available at http://www.abare.gov.au/publications_html/trade/trade_06/us_ag.pdf.

that receive the bulk of U.S. agricultural subsidies – corn, soybeans, wheat, rice, and cotton³⁴ – the total elimination of all subsidies and import protection would decrease U.S. production of corn, soybeans, and wheat by less than 3 percent each.³⁵ Only cotton and rice would see significant declines – and if the elimination of U.S. subsidies and tariffs were coupled with market-oriented multilateral trade liberalization, most of the projected decline in rice production would be eliminated, and U.S. wheat production would actually increase over current levels.³⁶

Thus, that the *Cotton* dispute has not been followed by additional challenges to subsidies for other commodities may not be a coincidence – in fact, the economic evidence that U.S. subsidy programs cause significantly increased U.S. production levels (or, in the case of rice, do anything other than offset foreign barriers to trade) of the other important program crops is considerably weaker than for cotton. As U.S. negotiators have said for years, the reduction of agricultural tariffs in the DDA would result in far more wealth maximization, especially for developing countries, than the elimination of U.S. subsidies.³⁷ Once again, the dollar value of subsidies is not necessarily indicative of the actual economic importance of those subsidies on trade.

³⁴ Although sugar and dairy benefit from price supports and other government interventions, these products are not eligible for the main agricultural support programs (direct payments, countercyclical payments, and marketing loans).

³⁵ *Id.* at 20.

³⁶ *Id.* at 25.

³⁷ *E.g.*, “Portman Defends U.S. Agriculture Proposal, Criticizes EU Market Access Offer,” *Inside U.S. Trade*, Oct. 12, 2005 (quoting then-USTR Rob Portman as citing a World Bank study as concluding that “92 percent of the benefit to the developing world” from the DDA “will come from market access,” not subsidy reduction).

2. What Subsidies Need to Be Disciplined in Trade Agreements?

If the sheer size of a government subsidy program is not the most important determinant of the effect of a subsidy on trade, on what basis do we distinguish between those subsidies that should be disciplined in trade agreements and those that – even if nominally much larger – are not of concern, at least from a trade perspective?³⁸

In a recent paper, Professor Alan Sykes contends that it may not be possible to develop rules that can adequately distinguish between subsidies that need discipline and those that do not.

He

argues that the detailed rules of the WTO and EU [state aid] are largely indefensible from an economic perspective. They fail to identify subsidization in any meaningful sense, and lack the capacity to distinguish socially constructive subsidies from those that are “protectionist” or are otherwise objectionable. The problems are likely irremediable, hinting that a laissez-faire attitude toward subsidies may be the best option.³⁹

While space precludes a detailed response here to all the issues raised in Professor Sykes’s provocative paper, the discussion above suggests a few possible delineations between subsidies that should cause concern and those that do not.

First – as Professor Sykes expressly recognizes – subsidies can have the effect of undermining previously negotiated market access commitments, and thus might be actionable as a non-violation nullification and impairment of anticipated benefits under a trade agreement such as the GATT.⁴⁰ The *Oilseeds* dispute provides a concrete example of this,⁴¹ and Article 5 of the

³⁸ I do not consider here whether international trade agreements might be an appropriate vehicle for diverting domestic political pressure for subsidies that, while not affecting international trade, are objectionable on other policy grounds.

³⁹ Alan O. Sykes, “The Questionable Case for Subsidies Regulation: A Comparative Perspective,” Stanford Univ. School of Law Law & Economics Research Paper Series Paper No. 380, Aug. 2009, at 1, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1444605.

⁴⁰ *Id.* at 19-20.

SCM Agreement expressly provides that nullification and impairment claims can be pursued as adverse effects claims subject to the special rules and enforcement mechanisms in that agreement. Alternatively, trade negotiators might link detailed subsidy disciplines to market access commitments as part of a package, as in the Uruguay Round agriculture negotiations as well as the DDA agriculture talks.⁴² In these cases the need for subsidy disciplines in trade agreements, and the scope for such disciplines, is clear.

A second, but necessarily less well-defined, category of subsidies that seems appropriate to discipline in trade agreements are subsidies that are “protectionist” in effect. As Professor Sykes explains in detail, however, establishing rules to distinguish “protectionist” subsidies in advance from other, less objectionable, subsidies creates a host of difficulties.⁴³ The SCM Agreement appears to reflect this problem by permitting unlimited subsidization (subject to rarely used CVD provisions) so long as the subsidies do not cause “serious prejudice” to other WTO Members – with the precise standards for determining the existence of such “serious prejudice” left to decision on a case-by-case basis.

One ought not to minimize the problems of relying on case-by-case evaluation of whether a subsidy is problematic or not. It is difficult to know in advance whether a proposed program would eventually be found WTO-inconsistent, and it is far from certain that the WTO dispute settlement mechanism can produce decisions in complex, politically charged cases that can command respect, if not agreement, from all concerned. At the very least, however, the

⁴¹ GATT 1947 Panel Report, *European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, B.I.S.D. 37S/ 86 (adopted Jan. 25, 1990).

⁴² Sykes, *supra* note 39, at 20.

⁴³ *Id.* at 31-35.

subsidies cited at the beginning of this paper – the *EU – Airbus* dispute and the financial bailouts – are not difficult cases.

If one accepts the U.S. analysis of the facts in the *EU – Airbus* dispute – that Airbus as we know it today would never have existed without subsidies, operating in a global market that almost certainly cannot support more than two full-range aircraft producers – then these subsidies are indisputably “protectionist” and distortive of world trade. Perhaps the EU perceives, as it stated in its submissions to the WTO panel, an “intolerability of being at the sole mercy of the United States in this critical industry,”⁴⁴ or that the social and political importance of the industry⁴⁵ makes “the forcible application of the general rules of the SCM Agreement” somehow improper.⁴⁶ Nonetheless, as Neven and Seabright concluded at the end of their study of the economic effects of the emergence of Airbus, “Airbus has had a large negative impact on world welfare but a comfortably positive impact on European welfare.”⁴⁷ If WTO subsidy disciplines permit the use of subsidies to achieve this result, they would mean little indeed.

By contrast, there is virtually no evidence that the financial industry bailout – despite the much larger sums involved – was designed to give U.S. financial institutions a leg up over their international competitors, or that they had such an effect. The U.S. Government did not provide

⁴⁴ EC First Written Submission in *EU—Airbus*, para. 48, Apr. 5, 2007, available at http://trade.ec.europa.eu/doclib/docs/2007/april/tradoc_134551.pdf.

⁴⁵ EC Oral Statement at the First Panel Meeting in *EU – Airbus*, para. 5, Mar. 20, 2007, available at http://trade.ec.europa.eu/doclib/docs/2007/march/tradoc_133827.pdf:

This is an industry with specific characteristics, not only economically, but also socially and politically. . . . Socially, it is one of the last mass-employment industries in economically advanced countries, with a very highly skilled workforce. Politically, it is an industry in which a lot of pride is invested, which is considered strategic and is closely interwoven with defence industries

⁴⁶ *Id.*, para. 6.

⁴⁷ Neven & Seabright, *supra* note 25, at 3.

massive funding to AIG, for example, in order to increase the global market share of the U.S. insurance industry. Rather, the primary motive appears to have been to prevent the systemic problems that would have resulted from the effects of a failure of AIG (and other institutions) on their counterparties, many of which were foreign entities. Whatever the merits of the bailout and its aftermath, any “protectionist” impact would seem to be of minor significance, if any at all, in its evaluation. Thus, the bailouts do not justify any relaxation of attention that is due to subsidies that do – despite their smaller absolute size – have significant, structural impacts on international trade.