

# **How to Free Trade: Dispute Resolution in the WTO**



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International Commerce  
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# **Basics of WTO Dispute Settlement**

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- ❖ **Dispute settlement central to WTO – without it, rules-based system would be less effective as rules could not be enforced**
- ❖ **WTO members have agreed that if other members are violating trade rules, they will use multilateral system of dispute settlement instead of taking unilateral action**
- ❖ **Members abide by agreed procedures and respect judgments**
- ❖ **Dispute arises when a country adopts trade policy other members consider is breaking WTO agreements**

# **Basics of WTO Dispute Settlement**

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- ❖ **Settling disputes is job of Dispute Settlement Body, consisting of all WTO members, with sole authority to:**
  - establish panels of experts to consider case**
  - accept/reject panel findings or result of an appeal**
  - monitor implementation of rulings**
  - authorize retaliation if country does not comply**
- ❖ **Dispute process can take up to 15 months depending on whether there is an appeal**
- ❖ **If country fails to comply with ruling, trade sanctions can be applied by complaining country in same sector**

# **Boeing vs. European Airbus**

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- ❖ **Support for developing new passenger aircraft first emerged as an issue in 1988 – European Airbus eating into Boeing's market with A320 jet**
- ❖ **In 1992, US and EU agreed on limiting provision of support for civil aircraft industry under “Bilateral EU-US Agreement on Trade in Large Civil Aircraft”**
- ❖ **Agreement limited launch aid to 33% of cost of developing aircraft, capped subsidies to Airbus, and support for Boeing limited to 3% of its turnover**
- ❖ **Can think of this bilateral deal as US and EU trying to “facilitate” collusion between Boeing and Airbus and save on cost of export subsidies**

# **Boeing vs. European Airbus**

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- ❖ **In 2004, Boeing walked away from bilateral deal on limiting export subsidies, claiming European Airbus A380 received launch aid of \$205 billion**
- ❖ **EU counter-argument - Boeing 787 is most subsidized aircraft in history, subsidies being channeled to Boeing through US Department of Defense and NASA**
- ❖ **Successive rulings by WTO panel/Appellate Body in 2010/11 (Airbus) and 2011/12 (Boeing) that EU and US subsidies violate WTO rules on export subsidies**
- ❖ **Compliance Panels ruled in 2016 that both firms had failed to comply with WTO rules on subsidies**
- ❖ **What is economic logic behind this dispute?**

# Boeing vs. European Airbus



# Boeing vs. European Airbus



<div style="display: inline-block; transform: rotate(-45deg);"> <math>s_A</math> </div> <div style="display: inline-block; transform: rotate(45deg);"> <math>s_B</math> </div>		Low output	High output
		<div style="display: flex; justify-content: space-between; align-items: center;"> <span>15, 15</span> <span>C</span> </div>	<div style="display: flex; justify-content: space-between; align-items: center;"> <span>20, 5</span> </div>
Low output			
High output		<div style="display: flex; justify-content: space-between; align-items: center;"> <span>5, 20</span> </div>	<div style="display: flex; justify-content: space-between; align-items: center;"> <span>10, 10</span> <span>N</span> </div>
High output			

$s_B$  = Boeing's strategy  
 $s_A$  = Airbus' strategy  
 N = Nash equilibrium  
 C = Collusive outcome

Boeing's profit  $s$  (first #)  
 Airbus' profits (second #)

# Boeing vs. European Airbus

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- ❖ Suppose neither US nor EU pays an export subsidy to its domestic aircraft firm, but each has same costs
- ❖ Boeing and Airbus then play a game in the international market where each chooses output to maximize its profits, given output choice of other firm
- ❖ Game has structure of a “prisoners’ dilemma”, where in a non-cooperative setting, each firm sets high output, even though they would be better off colluding and setting low output
- ❖ Dominant strategy of the game is the *Nash* equilibrium, i.e., each firm sets high output – even though firms would be better off colluding with each other



# Boeing vs. European Airbus



<div><div><div><math>c_{EU}</math></div><div><math>c_{US}</math></div></div></div>	No subsidy	Subsidy
No subsidy	<div><div>10, 10</div><div>C</div></div>	<div><div>20, 5</div></div>
Subsidy	<div><div>5, 20</div></div>	<div><div>7, 7</div><div>N</div></div>

$c_B$  = US strategy

$c_A$  = EU strategy

N = Nash equilibrium

C = Collusive outcome

Boeing's profits (first #)

Airbus' profits (second #)

# Boeing vs. European Airbus

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- ❖ **Now allow the EU to provide Airbus with an export subsidy, but suppose US does not give one to Boeing**
- ❖ **The subsidy lowers the costs of Airbus, who are now able to credibly increase their output and market share at the expense of Boeing**
- ❖ **However, US and EU governments face a “prisoners’ dilemma”, i.e., each should choose that policy that maximizes its firm’s profits, given the choice of the other country**
- ❖ **Each country will choose to provide an export subsidy, making both firms worse off as world price falls – rest of the world benefits – policy is self-defeating**

# Current Status of Dispute

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- ❖ **Appellate Board ruled in May 2018 that EU had failed to remove subsidies for both A380 and A350**
- ❖ **EU asked WTO in August 2018 to certify Airbus had complied with rulings on subsidies – thereby removing any basis for U.S. retaliatory sanctions**
- ❖ **WTO Appellate Board yet to rule on subsidies to Boeing from Washington state, NASA, Department of Defense, and EX-IM Bank – ruling expected March 2019**
- ❖ **A380 will cease to be built after 2021 due to weak orders, but A350 expected to be commercial success in competition with Boeing 787 and 777**
- ❖ **Boeing/Embraer and Airbus/Bombardier joint ventures**