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How the UK can deal with Tariff Retaliation: The Boeing-Airbus Fallout

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1. Tariff Retaliation

Tariff retaliation is allowed under World Trade Organisation (WTO) rules because the dispute settlement mechanism of the WTO is designed to promote compliance with its rules by allowing aggrieved parties to apply trade sanctions to parties who refuse to comply with those rules. However, so as not to impact sovereignty issues which might damage the entire dispute settlement mechanism, there is no WTO requirement for a country to bring its domestic laws and regulations into line with WTO rules. A country that chooses not to, will simply have to pay for the privilege by its exporters being exposed to tariff retaliation.

Prior to the WTO in 1994, the dispute settlement mechanism of the General Agreement on Tariffs and Trade 1947 (GATT) was ineffective because it relied too much on a diplomatic resolution of disputes. GATT panels could be vetoed by the losing party, leaving resolution of disputes in the diplomatic arena.

One of the reforms that was pushed in the Uruguay Round was a more legally rigorous approach to the WTO dispute resolution. This ultimately led to the formation of the WTO Dispute Settlement Body and the Appellate Body.

The precise amount of retaliatory tariffs that are available have also changed over time. In the early years of the WTO dispute settlement mechanism post 1994, there were a number of cases of 100% tariffs being sought to be imposed but these have become more limited until recently. In the period between 1994 and 2013, there were thirty-six requests for retaliatory measures, thirty-two involving tariffs. Interestingly, developing countries in some disputes, recognising that imposition of tariffs would be self-harming and would not give rise to the pressure needed to secure change in the developed countries, retaliated by withdrawing concessions agreed in the Trade Related Intellectual Property Agreement ("TRIPS") and services. These were the areas that were most politically sensitive for developed countries and implicate their important industry sectors, such as pharmaceuticals, high tech and other IP based industries. Ecuador, which has been quite creative in its use of retaliatory measures, also targeted Geographical Indications (GIs) in a dispute knowing that the EU had industries (French wine, Scotch whisky) which were both politically powerful and very reliant on GIs. The goal, as with all retaliation was to get the industries to stop the WTO violating behaviour by the EU by drawing its powerful industries in to countervail a significant vested interest that was benefiting from the ongoing WTO violation.

Parties relying on cross retaliation have adopted differing approaches. Some developing countries have focused cross retaliation on services sectors which are very similar to those at the heart of the dispute. Others have used much more wide-ranging sanctions in an effort to mobilise political forces.[1] The Canadians have embarked on cross retaliation in areas that are very specifically, and in a very focused manner aimed at maximising pain on the recalcitrant WTO member. For example, the Canadians have suspended the obligation to pursue an injury test in a subsidy's investigation (in another case involving export financing for aircraft where the defendant country was Brazil),

[1] Brazil used a very broad range of services cross-retaliation for its case against the EU involving cotton (Brazil – United States - Upland Cotton, DS267); Antigua and Ecuador used narrower services sector more closely tied to the sector at issue in the dispute for cases involving internet gambling (see US – Gambling – Article 22.6 DSU Arbitration with Antigua and Barbuda, DS 285, and EC-Bananas III – Article 22.6 DSU Arbitration with Ecuador, DS27).

suspended concessions under the Agreement on Textiles and Clothing and the Agreement on Import Licensing. In particular, the removal of the obligation to pursue an injury test means that subsidies are much more likely to be found (and returns to the pre-GATT Tokyo Round situation). Applied to developing countries, this will go directly to the export trade concerns of developing countries and make them more likely to comply.[2]

Retaliatory measures can have a damaging trade impact, and so in general they should be limited a) measures related to the sector in dispute or b) measures likely to bring about compliance because of political pressure. If measures do not satisfy either of these objectives, they will burden the international trading system for no justifiable reason.

2. Solutions to Boeing-Airbus Dispute

The Boeing-Airbus dispute is a long running dispute about large scale commercial aircraft. Boeing and Airbus are two of the world's largest large-scale commercial aircraft manufacturers. Both companies have complained over many years about the subsidies that both receive. The most recent WTO panel has found that both companies have benefited from illegal subsidies which must be removed in order for the US and EU to be WTO-compliant. Both the US and EU have alleged that neither party is complying with the ruling and both seek to suspend concessions as they are entitled to do under the WTO framework.

The Boeing-Airbus dispute has the potential to damage global trade in all sorts of unrelated areas. The retaliatory tariffs of both sides affect completely unrelated businesses who suffer tariffs and market share losses for reasons wholly outside their control.

At the same time, the UK and US are negotiating a free trade agreement (FTA) at the precise moment of the UK's entrance onto the global trade policy stage for the first time in forty years. This represents a significant opportunity for both parties. Negotiating such an agreement will involve overcoming some difficult issues such as agriculture, standards and the digital services tax, but it is equally important that neither party's asks fall into an "unreasonable" bucket. The UK should not be asking for tariff discrimination on the basis of process or production method, just as the US needs to rein in the impact of the Boeing-Airbus on UK businesses as a strong indication that they are now treating the UK differently from the EU. Indeed, the UK left the EU on 31 January 2020.

3. The UK can review the approach to subsidies for large scale commercial aircraft production

As the UK fully leaves the EU's common commercial policy, customs union and single market, which apply during the transition period, it has an opportunity to reset the relationship with the US in the context of the civil aircraft dispute. Furthermore, Covid-19 has meant that the need for large scale aircraft for airlines has significantly diminished. This is an opportunity for the UK to look again at the overall approach to subsidies and market distortions in this area. The OECD's Aircraft Sector Understanding ("ASU") (which is a "gentleman's agreement") is Annex III of the Arrangement on Officially Supported Export Credits. While it may be assumed that the UK will benefit from EU membership of this Arrangement, this does represent an opportunity for fresh thinking from the UK.

The UK is also contemplating its own anti-subsidy regime. This is an opportunity to look at the precise launch aid conditions, and how UK export financing works. While export financing

[2] See Brazil-Export Financing for Aircraft, DS46 (2000), Article 22.6 DSU (Canada)

arrangements are allowed under the OECD ASU, they are subject to limitations. For example, the ASU allows export financing subject to minimum premium and minimum interest rates.

Launch aid provided to UK Airbus has been repaid, according to the UK government. The conditions for launch aid and any subsequent payment by the UK government to Airbus UK entities will need to comply with the WTO Agreement on Subsidies and Countervailing Measures and the ASU. The UK, as a matter of trade policy will have to continue to make representations to Brussels regarding payments to the EU parts of Airbus by European member states. The UK government will have to develop a modus operandi if and when there are continuing violations by the EU of the ASCM, while at the same time, as a shareholder in Airbus working to ensure that the US does not violate the ASCM. This is a difficult challenge to be sure, but it is one the UK will have to learn to straddle as it will apply to many areas of UK-EU collaboration while the UK also maintains significant UK-US collaboration. It is not open to the UK government to ignore the issue and leave it for Brussels and Washington to solve. The UK has a vital stake in the solution not only because of its shareholding in Airbus, but also because of the corrosive effect on its other industries if the issue is not satisfactorily resolved.

4. US Retaliatory Tariffs

US retaliatory tariffs are used when the US has won a WTO panel ruling and the losing Member is deemed not to have brought itself into compliance. The purpose of retaliatory tariffs is usually to apply political pressure to the losing Member to force them into making the necessary changes to bring themselves into compliance. Historically, the US has targeted key industries that are thought to have political sway. For example, Scotch whisky has been targeted in the past because it is perceived to be a politically powerful industry.

However, the UK has left the EU and the transition period expires on 31 December 2020. The EU has made it very clear that it is not interested in prosecuting the interests of UK companies in its trade policy from now on. There is, therefore, no political capital to be drawn from pursuing UK companies using a punitive tariff as there would have been in the past.

Indeed, from a US objectives perspective, it is counterproductive to waste political leverage on UK industries as the political pain would be more effectively introduced on EU member state firms who might have political power with the European Commission.

The reasons set out in Section 1 above are not made out in this case and the retaliatory tariffs will cause extreme harm without any visible benefit for US interests.

5. US-UK FTA: Early Harvest

The UK and US are unlikely to conclude a full FTA before the US election, but that by itself is not fatal to build a strong UK/US relationship and an FTA shortly thereafter. As long as there is momentum behind the negotiation, this will benefit both the UK and US. One way of demonstrating momentum is to agree early harvest measures prior to the break for the US elections. These could be done as early as mid-August.

This could include:

(i) the closing of chapters that are relatively uncontroversial;

(ii) agreement to de-escalate tensions on the UK-US aspects of the Airbus-Boeing dispute including elimination of tariffs on unrelated sectors such as distilled spirits, proper application of launch

aid, and export financing where UK and US might be able to come to an agreement more easily than US and EU;

(iii) a group of measures and agreements that could constitute early harvest/phase one deal, which would include a fresh approach to trade disputes that allows for UK and US concerns in ongoing EU-US disputes – Airbus-Boeing and steel/aluminium – to be resolved directly and quickly, including an agreement that the US would not use retaliatory tariffs against the UK for actions taken by the EU; and

(iv) zero for zero tariff agreement on key sectors, including distilled spirits building on best practices from the UK-US Agreement on the Mutual Recognition of Certain Distilled Spirits/Spirits Drinks (2019). The UK and US spirits industries have set the standard on this approach by putting together a collective package as outlined below.

6. Damage to UK Industry, US Importers and Retailers and US Consumers

The retaliatory tariffs will damage UK industry but also US importers and US consumers.

The UK spirits industry (especially Scotch whisky) has been one sector that has been substantially impacted by US retaliatory tariffs since October 2019. Specifically, Single Malt Scotch whiskies and liqueurs from the UK have been subject to a 25% tariff into the US as a result of the dispute. This has led to a 25% fall in Scotch whisky exports to the US in the first six months since the decision and is causing lasting damage to the broader sector, which has been compounded by the economic impact of COVID-19.

The US Trade Representative (USTR) is due to review the tariffs on 12 August 2020 presenting a significant risk to the UK spirits industry for a potential increase in the rate and/or an expansion to include other categories, including other whiskies and gins from the UK.

Such an escalation would be devastating to a sector that delivers c£1.5 billion in exports every year to the US. Small distillers have driven industry growth over the last decade creating thousands of jobs, particularly across rural Scotland and England. But the tariffs could lead to over 6,500 UK jobs being lost from small distillers, farmers and others along the supply chain.

The job losses are likely to be concentrated in Scotland where over 90% of UK spirits are made, including 70% of gin production in the UK. Indeed, the total value of spirits production in Scotland that are exposed to tariffs is valued at c£1.4 billion, which is almost three times the estimated gains that Scotland will derive from a UK-US FTA over the long term (£517m). The Scotch whisky industry alone directly employs 11,000 people across Scotland, many in economically disadvantaged areas, and supports over 40,000 local jobs across the UK.

Importantly, this comes at an extremely sensitive time for the UK's internal market arrangements, where Scotland voted predominantly to remain in the EU in the UK's Brexit Referendum, while the UK as a whole, voted to leave. An internal market white paper has been released for consultation and it is anticipated that internal market legislation will be passed in September. Any damage to Scotland at the hands of the US will likely be used for political purposes to re-fight the referendum, or as an example of why Scotland should leave the UK's internal market. Such actions will completely undercut the UK governments attempts through its Internal Market White Paper and anticipated legislation to hold the Union together.

Such an escalation will therefore significantly erode support for the UK-US FTA in the UK, especially in Scotland. To the extent that the EU sees a developing rift between the UK and US, it will exploit it in

the context of its own negotiations with the UK, damaging UK and US shared long-term goals. It bears repeating that all of these harms will have no effect on the EU's behaviour. Indeed, if anything, the EU will not be unhappy with the result.

7. Industry initiatives

In trade policy, it is important to consider joint industry positions. Governments should not simply agree them because there are other considerations, in particular consumer concerns to be borne in mind, but assuming that joint industry positions are not damaging to consumers or potential new entrants, then weight should be paid to them.

The UK and US industry has agreed a common position and a compiled a set of requests for both governments. Essentially, they have called for a zero for zero tariff agreement (building on previous zero for zero deals going back to 1997). The industry has also called for a Working Group on Spirits to address TBT and SPS barriers between the two countries. Such an agreement could form part of an early harvest set of measures between the UK and US in anticipation of an FTA.

8. Conclusion

The UK-US FTA offers an opportunity to recalibrate the UK-US relationship as a distinct relationship between two sovereigns as opposed to its historic context as a relationship between a sovereign and a member state of the EU. Across industry sectors, the goal of the UK-US FTA should be to build bigger pooled markets with similar approaches on liberalisation and regulation, eliminating barriers to each other's exports. But it should also be to build stronger global markets for UK and US joint offerings such as in the area of financial services, defence and many others. The actual product market is usually not the two similar products that are competing, but wider global markets for larger categories. So, in Scotch whisky and Bourbon whiskey for instance, the relevant market is all spirits around the world. The UK-US FTA affords an opportunity to build these synergies and broaden global markets for UK and US products.

The concept of early harvest measures in FTAs is not new and could be particularly appropriate in the case of the US-UK FTA. We have suggested some early harvest measures that would be appropriate in this paper and recommend that the UK and US adopt them in order to ensure that the fallout of an essentially US-EU dispute does not damage the new alignment between the UK and US.

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