

SUBSIDY CONTROL IN WTO

**CASE STUDY: UNITED STATES – MEASURES AFFECTING TRADE-IN
LARGE CIVIL AIRCRAFT – SECOND COMPLAINT**

THESIS



By:

LELIANA GALUH MANIKA

Student Number: 16410102

INTERNATIONAL PROGRAM

UNDERGRADUATE STUDY

FACULTY OF LAW

UNIVERSITAS ISLAM INDONESIA

YOGYAKARTA

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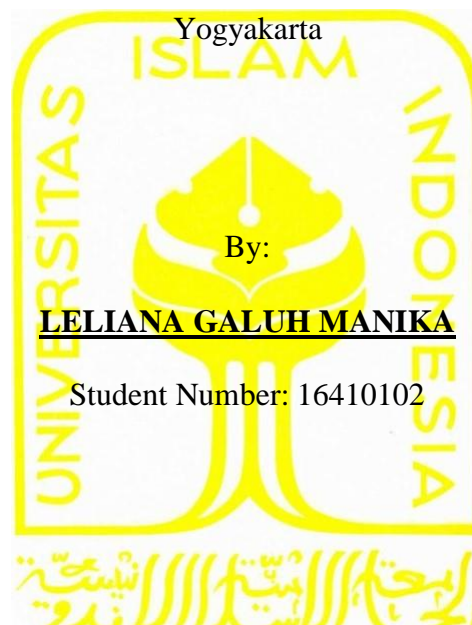
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Presented as the Partial Fulfillment of the Requirements
to Obtain a Bachelor's Degree at the Faculty of Law

Universitas Islam Indonesia



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UNDERGRADUATE STUDY

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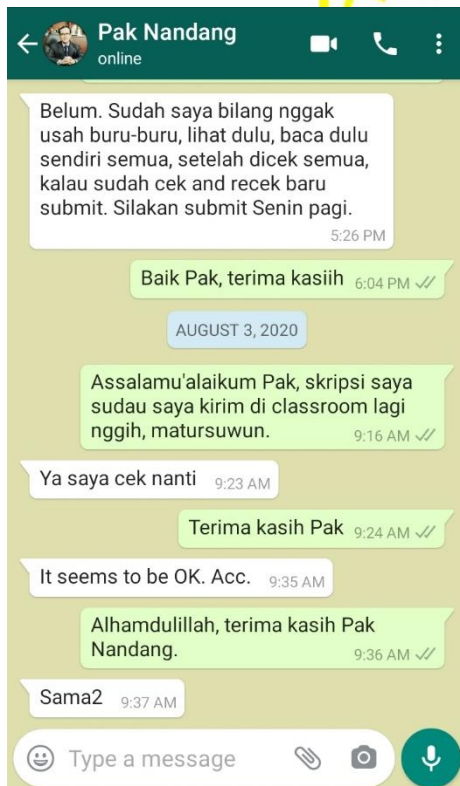
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Has been examined and approved by Thesis Supervisor submitted before the

Board of Examination in Final Thesis Examination

Date on August 3rd, 2020



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بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

SUBSIDY CONTROL IN WTO

CASE STUDY: UNITED STATES – MEASURES AFFECTING TRADE-IN
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Has been approved by Language Advisor to be submitted in front of Board of
Examiners in an oral exam

Date on



Yogyakarta, August 11, 2020

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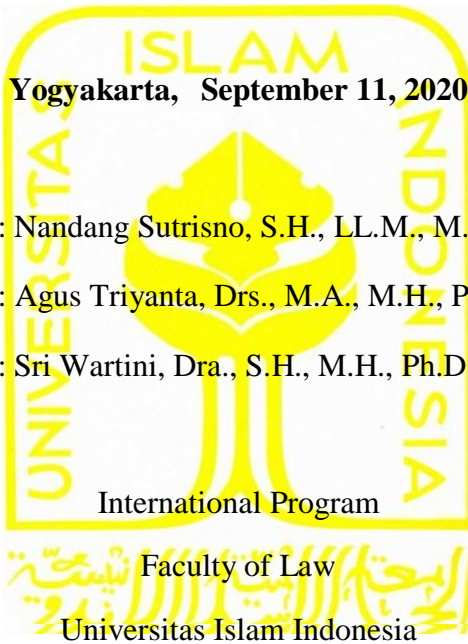
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Klaten, 4 Agustus 2020

Yang membuat pernyataan,



Leliana Galuh Manika

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- d. Delegate in London International Model United Nations (LIMUN), London, UK, 2018.
- e. Delegate in Diponegoro International Model United Nations (DIMUN), Semarang, Indonesia, 2017.
- f. Verbal Commendation Award in Surakarta International Model United Nations (SIMUN), Surakarta, Indonesia, 2017.

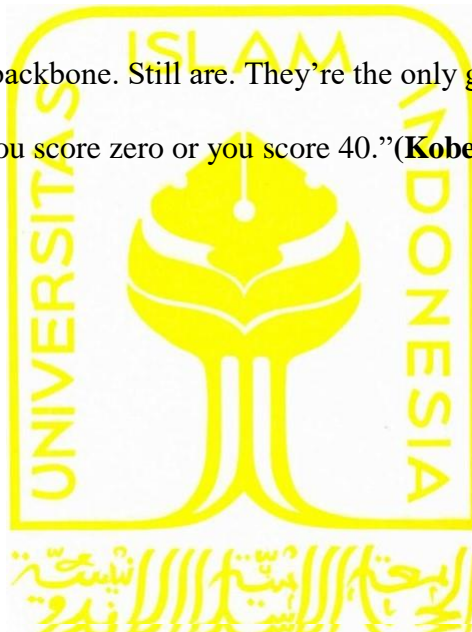


MOTTO

“If you can’t stand the fatigue of study, you will feel the poignant of stupidity.”

(Imam Syafi’i)

“My parents are my backbone. Still are. They’re the only group that will support you if you score zero or you score 40.”**(Kobe Bryant)**



DEDICATION



With gratitude to Allah S.W.T.,

The author dedicates this thesis to:

*Bapak, Ibuk, Masyan and all of my family
who always support me and pray for me...*

*and surely for myself, thank you for
not giving up, and able to prevent yourself from
negativity. Many more to go Lel, this is only your
beginning, cheer up!*

*Lastly, for all of my best friends wherever you are,
thank you for your support, inspiration and prayer for
me, even though we are all separated by Covid-19...*

ACKNOWLEDGEMENT

Bismillahirrahmaanirahiim

Assalamualaikum Wr. Wb.

First, I want to thank to Allah S.W.T., who has given me love, strength and bless, and by that I can finish this Thesis, that entitled as:

“SUBSIDY CONTROL IN WTO

CASE STUDY: UNITED STATES – MEASURES AFFECTING TRADE-IN LARGE CIVIL AIRCRAFT – SECOND COMPLAINT”.

Without His grace and help, none of this will ever happen.

I am just an ordinary human that could not make something as perfect as what Allah did, this thesis is far from what is called as perfect, but I have complete it with full of my dedication and strength, so I could receive my bachelor degree and raise honor to my family. Then, by that, all grateful and thanks are belong to:

1. **Mr. Fathul Wahid, S.T., M.Sc. Ph. D**, as the Rector of Universitas Islam Indonesia, for the permission to write this thesis.
2. **Mr. Dr. Abdul Jamil, S.H., M.H.**, as the Dean of Faculty of Law, Universitas Islam Indonesia, for the permission to write this thesis.
3. **Mr. Dodik Nur Heryanto, S.H., M.H., LL.M., Ph.D.**, as the Secretary of International Program Faculty of Law Universitas Islam Indonesia, thank you for always try to be there when your students need you, and thank you for your dedications to improve the quality of International Program Class.

4. **Mrs. Dra. Sri Wartini, S.H., M. Hum., Ph.D.**, thank you for guide me when I need some suggestions and when I will do competitions, thank you for all your love and patience when you teach your students, and you are more than a lecture for me and my friends, you are our mother in IP FH UII, thank you.
5. **Mr. Nandang Sutrisno, S.H., LL.M., M.Hum., Ph.D.** as my thesis supervisor. Thank you for always guide me on the process of making my thesis, thank you for all of your patience when you teach your students, and last thank you for introduce me with the International Trade Law.
6. **Ms. Rina Desitarahmi, S.Pd., M.Hum.**, as my language advisor who help me to make my English thesis is much better than before, because without your help, this thesis will not be complete, and thank you for spent your time to evaluate my English grammar, have a blessful life Miss .
7. **Ibuk**, a.k.a Momss, my key to Allah blessing. The door to His *Jannah*. No words or action of thank will ever be sufficient to give. The one who give endless prayers to Allah in every of her *Shalat*. The one who never tired to remind me to *Shalat*, read *Qur'an*, and share to others who need. My best friend at home or everywhere we go, who always laugh with me and be there for me. May Allah give you long and healthy life so I can show you that I will be a success human, not only in the matter of world, but also *akhirat*. Nothing in this world can repay your sacrifice, but I hope I can bring joy and happiness in your life.
8. **Bapak**, as the first man who loves me fully and unconditionally, the one who makes me feel safe and protected. The one who fights with full of his sweats

to make my family live on easy street. Thank you for all of your support and wishes, without you I will not be able to stand alone by myself, even you know that your daughter already in her 20s, you still hold her like she does not know how cruel and hard this world is. May Allah always gives health, wealth, and happiness in your life *aamiin*.

9. **My brother**, even you are super annoying person, but I know that you also love me unconditionally, haha! Thank you for make me feel accompanied when there is no one that I can meet, well, you know, COVID-19. Thank you for brought me such a fluffy cute best friend a.k.a Noik. I'm blessed because I have brother, even his personality is sometimes an issue for me, but that's fine, I know that is how siblings life, lol, okay, that's it, love ya.
10. **Alfianno**, the one who fill my joy when we were still a university student, and high school too! Thank you for always be there when I need a place to lean on, when I lost, and when I was in my lowest. Thank you for always support me for every step that I took, without that support and positivity I don't think I will be who I am right now. Thank you! Last but not least, have a bright future fin, and be a good human being as what you always ask me to do!
11. **IP Class of 2016**, my super noisy classmates, Nadia, Hana, Hima, Sofia, Cantika, Ovin, Elsha, Meilin, Alip, Dana, Abi, Reff, Siraj, Mas Oscar, Dani, Jihad, Haris, and Faishal Al. Thanks for all the years we've been through as a university student, I'm blessed for having smart, funny, and silly classmates, sheesh, I miss that moment already. I hope we will be able to see each other

again as a successful human being. And guys, have a long life full with happiness, and joys, where ever you will go, see you again!

12. **My Psychiatric mates**, Ningrum, Intan, Khalid, and Fajar. Thank you, for every counseling that we've been made, it makes me able to share my sadness and happiness. Thank you for being my best friend since we were such a pure little teenagers. Even we do not hanging out often, I wish our friendship will last longer. And then, for all the dirty jokes, support and wishes, thank you. You guys mean a lot to me!

13. **SAIL**, thank you for giving me so many new insights on law, especially international law, without SAIL it will be hard for me to find what subject that I loved. With SAIL also, I could have the experience to do legal writing and legal speaking, especially on every competition preparations. I was introduced with moot court, and be able to meet my moot court empires, thank you, these experiences were worth and amazing.

14. **My MUN Mates**, Idznila, Alip, Danti, Zul, Kak Dira, Kak Syeila, Kak Hani, and Bang Bintar. MUN experiences were awesome and unforgettable, even though it makes me a lil bit sensitive with the hotel smell, lol. Btw, you guys are really smart and absurd, but I like that. Thanks for every memories that we had together, I was enjoyed that so much. Hope you guys are doing well, see you again!

15. **KKN Unit 305**, Risma a.k.a emeng, Dinda, Chelly, Iyan, Zehan, Bang Toshi, Bapak ibuk Posko 305, and Mas Adi. My lovely Krajan mates, a month is not enough! Even we were only knowing each other in a very short time, but I

know that you guys are kind, smart, funny, and honest human. I'm a person who are not easily can be friend in a new group, but you guys are different, thank you for accepting me and my flaws. Let's go somewhere without doing "Tugas KKN", lol.

16. **Highschool Mates**, Alfin, Rey, Pujas, Alfi, Ivan, etc. thank you for spending your time to hanging out with me while I was in Jogja, I enjoyed that so much, let's have a trip to somewhere, to do list!

17. To everyone who contributes on my journey when I was an undergraduate students, thank you!



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ABSTRACT

The case of *US – Large Civil Aircraft* was arise in 2004, where European Union on behalf of Airbus submitted their complaint toward violation conducted by the United States on behalf of Boeing. European Union claimed that there were numerous subsidies provided by the United States to Boeing. The subsidies were in the form of tax exemption, tax incentives, property and sales tax breaks, payments and access to government facilities, equipment and employees. Those subsidies were provided by numerous U.S government institutions. European Communities (EC) will suffer losses if U.S kept on supplying Boeing through the subsidies, especially if the characteristic of subsidy is included as prohibited subsidies. By that, EC filed the complaint of DS353 to avoid more losses and violation conducted by its rival. In this thesis, the research concerned on how the subsidy controls are conducted by World Trade Organization in order to make a fair and just international trade competition, what kind of prohibited subsidies given by United States to Boeing, and the reasons that make the subsidies are categorized as prohibited subsidies. To help answering the issues, this thesis used the normative legal research through analyzing legal documents provided by World Trade Organization, which are the Agreement on Subsidies and Countervailing Measures, the DS353 case documents. Also, this research used two approaches which were statutory approach and conceptual approach. The researcher also conducted qualitative data analysis from numerous sources, not only from the legal documents, but also some journals and articles. From the research methods that used, this research thesis was able to answer the issues on how World Trade Organization controls the subsidy and what are the reasons of subsidies from U.S to Boeing were categorized as prohibited subsidies. The researcher answered the subsidy controls conducted through a special institution under the World Trade Organization, namely the Committee on Subsidies and Countervailing Measures, and this committee is responsible on receiving subsidy notifications from Members State. Second, the prohibited subsidies received by Boeing are concerning the special legislations from U.S relating to the tax exemption, by the legislation, Boeing could avoid and delay their company on paying taxes. Thus, there is a need to make the subsidies regulation more assertive, in order to make the Member States respect the applicable law, and create fair trade competition.

Keywords: Prohibited Subsidies, Control of Subsidies, Boeing, Airbus.

CHAPTER I

INTRODUCTION

A. Background of Study

The matter of subsidy is important in international trade, the regulation had arisen and called as Agreement of Subsidies and Countervailing Measures hereinafter as “SCM Agreement”. The agreement had two purposes which are to create disciplines on the use subsidies, and govern countries to do a counteract on regards of the effects of the subsidies.¹ Before the Agreement of Subsidies and Countervailing Measures was put into force, there were processes on the appearance of subsidy regulation. Firstly the regulation was written under Havana Charter from *International Trade Organization* (ITO), then the organization was replaced with the *General Agreement on Tariffs and Trade* (GATT). In that regime, the subsidy agreement was renewed and called as the *Subsidies Code*, the renewal was made on *Tokyo Round 1979*,² the code sought to "reduce or eliminate the trade restricting or distorting effects"³ of subsidies.⁴ In the period of GATT, the subsidy regulation was improved through the *Uruguay Round 1994*, which produced the

¹ Understanding the WTO: The Agreements ‘Anti-dumping, subsidies, safeguards: contingencies, etc’, Official Website of WTO, https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm accessed on 24 of December 2019.

² Andrew Lang, *Governing ‘As If’: Global Subsidies Regulation and the Benchmark Problem*, (University of Michigan Law Library: 2014), 141; H.S. Kartadjoemena, *GATT dan WTO ‘Sistem, Forum dan Lembaga Internasional di Bidang Perdagangan’*, (Jakarta: UI Press, 2002), 110.

³ Subsidies Code ‘Tokyo Round’, Preamble para. 1.

⁴ Jeffrey D. Kienstra, “Cleared For Landing: Airbus, Boeing, and the WTO Dispute over Subsidies to Large Civil Aircraft”, *Northwestern Journal of International Law & Business*, Volume 32, Issue 3 (2012): 579.

Agreement on Subsidies and Countervailing Measures and the DSU (*Dispute Settlement Understanding*) that still available currently.⁵ This research used the *Agreement on Subsidies and Countervailing Measures* as the primary legal basis after the GATT Text.

The problem of subsidy could be included as unfair trade practices based on international rules, because subsidy is an action that may give harmful effects on trade and production.⁶ Therefore, to prevent the harmful effects on subsidies and to respect the law, GATT rules respond to the subsidized imports by imposing a countervailing duty,⁷ followed with the international regulations on subsidies which currently WTO has the regulation named as the Agreement on Subsidies and Countervailing Measures.

In order to understand what are the violations of Agreement on Subsidies and Countervailing Measures that alleged to the US, and answering the problem that is formulated, this research tried to examined and explained comprehensively in the next chapter of this research.

World Trade Organization (WTO) was having serious yet complicated cases concerning the violation of Agreement on Subsidies and Countervailing Measures allegedly conducted by the United States on providing subsidies for Boeing, and this matter is quite interesting to tell. Previously, on October 6th, 2004, the US government on behalf of Boeing Company filed a complaint to the World Trade

⁵ *Ibid*, p. 580; Nils Meier-Kaienburg, "The WTO's —Toughestl Case: An Examination of the Effectiveness of the WTO Dispute Resolution Procedure in the Airbus–Boeing Dispute Over Aircraft Subsidies", 71 *J AIR L. & COM.* 191 (2006): 201.

⁶ Subsidies Code, Preamble, *Op. Cit*, para. 3.

⁷ John H. Jackson, "The World Trading System 'Law and Policy of International Economic Relations'", *The MT Press, Cambridge*, (1994): 249.

Organization against the European Union's Airbus.⁸ Boeing presumed that Airbus had received illegal aid from the EU in terms of subsidization and violated the international trade policies of WTO. In 24 hours, Airbus submitted the same complaint against Boeing. Airbus also presumed that the US government gave illegal aids to Boeing.⁹ This case, however, became further than a simple fight between two big companies,¹⁰ and this paper focused on the case filed by the European Union alleging the U.S about the illegal subsidization.

The case is between EC Airbus Company and US Boeing Company, they had the same high level of market on Large Civil Aircraft in the world. Their growth and stable position recognized by the world,¹¹ make them a great rival on LCA. However, these two big companies have different philosophy on the market that clearly showed on the matter of subsidization.¹² The European political systems usually combine public and private sectors to involve in the matter of subsidization, through helping the industries on direct grants and tax concessions. Then, the US had always been using the principle of free market, hence, the matter of subsidization is commonly acceptable.¹³ Thus, Boeing – Airbus was against each other basically because of their ideologies, the free-market principle America

⁸US — *Large Civil Aircraft (2nd Complaint)*, Summary of the Dispute, 17 July 2019, available at https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds353_e.htm accessed on 2 February 2020; Meier-Kaienburg, *Op. Cit.*, 201&205; Request for Consultations by the United States, European Communities and the Certain Member States—Measures Affecting Trade in Large Civil Aircraft, WT/DS316/1 (Oct. 6, 2004) [hereinafter '*EU – Aircraft Request for Consultations*'].

⁹ *Ibid*, Meier-Kaienburg, p.207; Request for Consultations by the European Communities, *US — Large Civil Aircraft*, WT/DS317/1 (Oct. 6, 2004) [hereinafter '*US — Large Civil Aircraft Request for Consultations*'].

¹⁰ Yujin Baskett, "Clash of the Titans: Boeing, Airbus, and the WTO", *Otago Management Graduate Review*, Vol 8 (2010): 1.

¹¹ Meier-Kaienburg, *Op. Cit.*, 195-196.

¹² Meier-Kaienburg, *Op. Cit.*, 196.

¹³ Meier-Kaienburg, *Loc. Cit.*

and state-supported European.¹⁴ This research put aside about the ideologies, and focus more on what kind of subsidies violation that occurred.

The case of Boeing and Airbus started from the negotiation on the making of subsidies limitations for commercial jetliners agreement between US and EU, the agreement called for a ceiling on the amount of direct government support for new aircraft programs (launch-aid subsidies). Airbus was limited to 33 percent of development costs and indirect subsidies to Boeing were limited to 3 percent of revenue,¹⁵ and the cost shall be repaid to the government no more than 17 years period.¹⁶ After the signing, Airbus Company as the side of EU steadily gained their share and commerce, and became larger in each year. Then, Boeing company as the side of the US withdrawn from the agreement and filled complaint to WTO Dispute Settlement Body, alleged that the European Communities had violated the agreement by providing illegal subsidies to Airbus.¹⁷ EU responded to the complaint as soon as the US complaint was filed, and did a complaint for the US since the US gave "massive subsidies" to Boeing.¹⁸

The United States had been known for providing subsidies to Boeing since 1984,¹⁹ as reported by European Commission:

"For many years the US Government has subsidized Boeing, mainly by paying research and development costs through NASA, the Department of Defence, the Department of Commerce and other government agencies. Since 1992 Boeing has received around \$ 23 billion in US subsidies. Moreover, the US Government

¹⁴ *Ibid.*

¹⁵ John Olienyk, and Robert J. Carbaugh, "Boeing and Airbus: Duopoly in Jeopardy?", *Global Economy Journal*, Vol. 11, Iss. 1, Article. 4 (2011): 2.

¹⁶ Robert J. Carbaugh and John Olienyk, "Boeing-Airbus Subsidy Dispute: A Sequel", *Global Economy Journal*, Vol. 4, No. 2, Article 6 (2004): 2.

¹⁷ Robert J. Carbaugh and John Olienyk, *Op. Cit.*, p. 3.

¹⁸ *Ibid.*

¹⁹ Mississippi Law Journal, "Subsidizing Large Civil Aircraft: Airbus and Boeing's Newest Dispute Before the World Trade Organization", Vol. 86, p. 45.

continues to grant Boeing around USD 200 million per year in export subsidies under the Extraterritorial Income Exclusion Act (the successor to the “FSC” - Foreign Sales Corporations legislation), despite a WTO ruling expressly declaring these subsidies illegal.”²⁰

Moreover, the US government also had provided another aid for Boeing such as tax exemption for the foreign trade income.²¹ Then, Boeing also received subsidies from the part of US Government, which is NASA, in the form of research grants and advanced technology development through NASA's R&D subsidy programs that began in 1989 and early 2000s,²² and there were still other subsidies received by Boeing. In the summary of the case, the U.S has allegedly provided subsidy in form of (i) payments, access to government facilities, equipment and employees, allocation of intellectual property rights, and reimbursement of independent research and development (“R&D”) costs under R&D contracts and agreements between Boeing and the National Aeronautics and Space Administration (“NASA”), the United States Department of Defence (“USDOD”) and the Department of Commerce; (ii) various federal, state and local tax measures; and (iii) infrastructure-related measures.²³

Then on 27 June 2005, European Communities requested consultation regarding the prohibited and actionable subsidies provided to US producers of large civil aircraft, and EU requested the consultation about the United States who

²⁰ European Trade Commission, *US-Boeing: EU Takes US to the WTO Over Subsidies Granted to Boeing* (2004) available on http://europa.eu/rapid/press-release_IP-04-1191_en.htm?locale=en, accessed on March 6, 2020. [European Trade Commission, US-Boeing]

²¹ United States Congress website, *H.R.4170 – Deficit Reduction Act of 1984*. Available at <https://www.congress.gov/bill/98th-congress/house-bill/4170>, accessed on March 16, 2020.

²² World Trade Organization, *US — Large Civil Aircraft (2nd Complaint)* Report of the Panel, WT/DS353/R, 2011, p. 682. [*US — Large Civil Aircraft (2nd Complaint)* Report of the Panel]

²³ *US — Large Civil Aircraft (2nd Complaint)* Summary of Case, *Loc. Cit.*

did not able to comply with Articles 3.1(a), 3.1(b), 3.2, 5(a), 5(c), 6.3(a), 6.3(b) and 6.3(c) of the SCM Agreement and Article III:4 of the GATT 1994.²⁴ Thus, the complaint was filed as case number DS353 “*US — Large Civil Aircraft (2nd complaint)*” in the World Trade Organization Dispute Settlement Body.

As from what mentioned above, there were at least two issues that become the researcher’s concern, first was concern on how World Trade Organization could manage or control the subsidies of international trade, so the international traders feel secured when they conduct trading, and there is no unfair competition occur.

Second, was concern on how World Trade Organization could declare whether the subsidies are prohibited under the Agreement of SCM or not, and are there any official notifications from every state to notify WTO about their subsidies or the WTO conduct the operations by themselves to find any subsidies that received by the member state.

This research paper is related to two big companies which are dominated the sales of Large Civil Aircraft around the world, the WTO Members which conduct sale and purchase with both of the companies shall aware about this case even though there is no direct impact to them, but the Members shall know about the natures or the sources of the LCA that they purchased. Then, both of the companies also must aware too, that they shall provide fair business practices under the WTO, and as much as possible to avoid any kind of prohibition that

²⁴ *Ibid.*

regulated, because the WTO appears to make the trade around the world is fair competition and give benefits to every Members.

B. Problem Formulation

1. How did WTO control the subsidy under the Agreement of Subsidies and Countervailing Measures?
2. Why were the subsidies received by Boeing categorized as prohibited subsidies?

C. Purpose of Study

1. To analyze how WTO controls the subsidies under the Agreement of Subsidies and Countervailing Measures.
2. To uncover the reasons why were the subsidies received by Boeing categorized as prohibited subsidy.

D. Research Originality

This research focused on the matter of subsidy controlled under WTO regulation and aimed to understand the case between the U.S and European Union which alleging U.S on providing aids to the Boeing company illegally and considered that as the violation on Agreement of Subsidies and Countervailing Measures. Besides, this research also wrote how to distinguish subsidies that categorized as prohibited subsidies or not.

To know that this research is original, here the writer put the other research paper and journal to compare and to establish that this research paper is original. The first comparison is from a Thesis written by Fina Dwi Rahmadaningsih about The non-compliance of the United States towards the World Trade Organization's

Subsidies and Countervailing Measures Agreement related to the prohibited and actionable subsidies dispute case for the Boeing Large Civil Aircraft with the European Union in 2004-2012.²⁵ In that thesis, Fina explains the reasons why United States did not obey the SCM Agreement related to the subsidy case between Boeing – Airbus. She explains about the reasons why U.S did not obey the SCM Agreement. Meanwhile, this research explained about two main concerns, it was about the subsidy control under WTO and about why aids/subsidies given by the U.S to Boeing categorized as prohibited subsidies.

Second, from the thesis of Putri Syahrina, her thesis is about subsidy regulation in International Trade based on SCM Agreement and its implementation in Indonesia.²⁶ In her thesis, she explains how WTO regulates subsidies through the SCM Agreement, and how the subsidy regulation implemented in Indonesia. Meanwhile, the research were about how WTO controls subsidies through the SCM Agreement by providing certain cases that ever arose, then this research explain the prohibited subsidies from the U.S to Boeing, and this point did not explained in Putri's thesis.

Third, the article of Robert J. Carbaugh and John Olienyk on “Boeing-Airbus Subsidy Dispute: A Sequel”²⁷ explained about the comparison of Boeing and Airbus, the histories and chronologies of the case and the same position of U.S and

²⁵ Fina Dwi Rahmadaningsih, “Ketidakpatuhan Amerika Serikat Terhadap Peraturan *Subsidies and Countervailing Measures Agreement World Trade Organization* Terkait Kasus Sengketa Pemberian Subsidi *Prohibited* dan *Actionable* Untuk *Boeing Large Civil Aircraft* Dengan Uni Eropa Tahun 2004-2012”, Bachelor Thesis, Universitas Brawijaya, 2018.

²⁶ Putri Syahrina, “Pengaturan Subsidi Dalam Perdagangan Internasional Berdasarkan SCM Agreement (Agreement on Subsidies and Countervailing Measures) dan Implementasinya di Indonesia”, Bachelor Thesis, Universitas Bung Hatta, 2017.

²⁷ Robert J. Carbaugh and John Olienyk, “Boeing-Airbus Subsidy Dispute: A Sequel”, *Global Economy Journal*, Vol. 4, No. 2, Article 6 (2004).

EU provide subsidies. Meanwhile, this research were about the subsidy control, the article did not mention how WTO controls subsidies but only explained the position of Boeing and Airbus, how were their market, and what subsidies that received by these companies.

Fourth, the article of Jeffrey D. Kienstra “Airbus, Boeing, and the WTO Dispute over Subsidies to Large Civil Aircraft”²⁸ explained broadly about the procedure on settling the case, from the complaints, procedure, and panels of the case, and also explains about the chronologically. Meanwhile, this research were concerned on WTO controls over subsidies and about the prohibited subsidies received by Boeing, because in Kienstra's journal he did not mention specifics about how WTO controls subsidies and such.

Lastly, the article of Nils Meier-Kaienburg “WTO's toughest Case: an examination of the effectiveness of the WTO Dispute Resolution Procedure in the Airbus-Boeing dispute over aircraft subsidie”²⁹ explained the effectivity of the dispute settlement mechanism used by WTO to settle this subsidy case, then about the dispute settlement process from the consultation, establishment of the panel, then to the ruling that made by WTO. This thesis research did not discuss on the effectiveness of WTO on ruling the case, but this thesis discussed how WTO controls subsidy through the SCM Agreement.

Table 1. Research Originality, comparison between this thesis research with another author's research papers/articles.

²⁸ Jeffrey D. Kienstra, “Cleared For Landing: Airbus, Boeing, and the WTO Dispute over Subsidies to Large Civil Aircraft”, *Northwestern Journal of International Law & Business*, Volume 32, Issue 3 (2012).

²⁹ Nils Meier-Kaienburg, “The WTO's Toughest Case: An Examination of the Effectiveness of the WTO Dispute Resolution Procedure in the Airbus-Boeing Dispute over Aircraft Subsidies”, *Journal of Air Law and Commerce*, Volume 71, Issue 2, Article 2 (2006).

No.	Name Of Author, Research title, Research type, year.	Research problem formulation	The Different Points From This Thesis Research
1.	Fina Dwi Rahmadaningsih, Ketidakpatuhan Amerika Serikat Terhadap Peraturan <i>Subsidies and Countervailing Measures Agreement World Trade Organization</i> Terkait Kasus Sengketa Pemberian Subsidi <i>Prohibited dan Actionable</i> untuk <i>Boeing Large Civil Aircraft</i> dengan Uni Eropa Tahun 2004- 2012, Thesis,	A. Why America did not obey the SCM Agreement under WTO relating to the case on providing Prohibited and Actionables Subsidies for Boeing Large Civil Aircraft with European Union (2004-2012)?	A. This thesis research explained why the subsidies provided by the U.S to Boeing categorized as prohibited subsidies, and not explained about the reasons why U.S disobey the SCM agreement. B. This thesis research also added an explanation on how WTO controls subsidies under the SCM Agreement, which this part was

	Universitas Brawijaya, 2018. ³⁰		not explained by Fina.
2.	Putri Syahrina, Pengaturan Subsidi Dalam Perdagangan Internasional Berdasarkan SCM Agreement (Agreement on Subsidies and Countervailing Measures) dan Implementasinya di Indonesia, Thesis, Universitas Bung Hatta, 2017. ³¹	A. How the subsidies regulation in international trade based on the SCM Agreement? B. How the implementation of subsidies regulation of international trade in Indonesia?	A. This research thesis the writer explained on how WTO controls subsidies through the SCM Agreement, not only understood about the subsidies regulation, but also the control of subsidies. B. This thesis research focused on the case of the U.S and EU in regards to Boeing and Airbus, to know why the subsidies provided by the U.S

³⁰ Fina Dwi Rahmadaningsih, *Loc. Cit.*

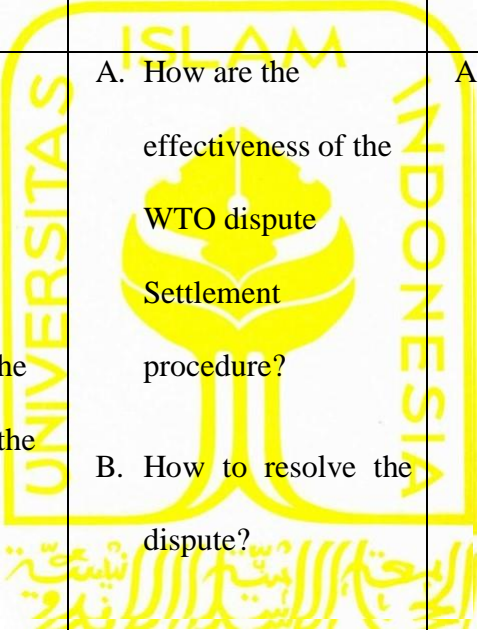
³¹ Putri Syahrina, *Loc. Cit.*

			<p>categorized as prohibited subsidies, and this thesis not explained about the subsidies regulation in Indonesia.</p>
3.	<p>Robert J. Carbaugh and John Olienyk, Boeing-Airbus Subsidy Dispute: A Sequel, Global Economy Journal, 2004.³²</p>	<p>A. Analyzing the trade frictions between Boeing and Airbus regarding governmental subsidies and its implications for the conduct and performance of the two companies in the commercial aircraft industry</p>	<p>A. This research thesis, the writer focused on the complaint received by the United States, to analyzed why Boeing got subsidies from the US but they were categorized as prohibited subsidies.</p> <p>B. Then, this research also explained on how did WTO</p>

³² Robert J. Carbaugh, and John Olienyk, *Loc. Cit.*

			control the subsidies under the SCM agreement which this point was not mentioned in Mr. Carbaugh and Olienyk's journal.
4.	Jeffrey D. Kienstra, Cleared For Landing: Airbus, Boeing, and the WTO Dispute over Subsidies to Large Civil Aircraft, Northwestern Journal of International Law & Business, 2012. ³³	A. How the dispute resolution process of the World Trade Organization over subsidies provided by the European Communities to Airbus?	A. This research explained on how did WTO control subsidies under the SCM Agreement, and not focused to explain the settlement process of the case. B. This research also explained directly about subsidies, especially on the subsidies provided

³³ Jeffrey D. Kienstra, *Loc. Cit.*

			by the U.S government to Boeing, and why those subsidies classified as prohibited subsidies under the SCM Agreement.
5.	Nils Meier-Kaienburg, The WTO's Toughest Case: An Examination of the Effectiveness of the WTO Dispute Resolution Procedure in the Airbus-Boeing Dispute over Aircraft Subsidies, Journal of Air Law and Commerce,	 <p>A. How are the effectiveness of the WTO dispute Settlement procedure?</p> <p>B. How to resolve the dispute?</p>	<p>A. This research explained on how did WTO control subsidies under the Agreement of SCM, and not examined whether WTO resolve this dispute effectively or not.</p> <p>B. This thesis also focused on the matter of subsidies, why the subsidies provided by the U.S</p>

	2006. ³⁴		government categorized as prohibited subsidies.
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Thus, this research paper is different from other research papers mentioned above. This research paper focused on explaining how the WTO controls the subsidy of the Members State, besides that, it also brought the case that related to subsidy and discussed the prohibited subsidy that occurred. The other five researches/articles above did not write about this issues, most of them discuss about the process of the dispute settlement, the implications of the SCM Agreement, and why a state violate SCM Agreement. Then, the contribution of this research paper is to support academics who have concern on WTO, SCM Agreement, and subsidy, because this research paper will help a little or much on the academic problems within that scope.

E. Literature Review

International law governs and manages many branches of study such as international criminal law, international trade law, human rights,³⁵ and etc. International law itself different from what we call "Domestic Law / National Law", because international law has no central legislator to make the rules.³⁶ The subject of international law who became the legislator is the states, and every state

³⁴ Nils Meier-Kaienburg, *Loc. Cit.*

³⁵ Christoph Schreuer, "Sources of International Law: Scope and Application", Emirates Lecture Series 28, *The Emirates Center for Strategie Studies and Research.*

³⁶ Joost Pauwelyn, "The Role of Public International Law in the WTO: How far can we go?", *The American Journal of International Law*, vol. 95 (2001): 535.

is equal.³⁷ Even there is no central legislator, every state remains to obey international law because there are agreements or treaties, customary of international law that exists,³⁸ and those have the same character as a binding force.³⁹ Since there is no hierarchy between rules except for jus cogens, then the treaty norms such as United Nations Human Rights Council (UNHRC) have the same legal status with treaties under World Intellectual Property Organization (WIPO), and World Trade Organization (WTO) or a bilateral treaty.⁴⁰ Thus by that statement, we will understand that WTO rules have legal status as a binding force for the parties that is the member of it.

Then, in this research, the study is focus on the branch of international trade alongside some understanding about the World Trade Organization with one case that ever arose before. World Trade Organization or as we commonly know as WTO, is an organization that mainly has the purpose of liberalizing the trade,⁴¹ but remain to protect trade from any spread of diseases by supporting on applying barrier,⁴² liberalization of trade is a concept of goods and services trade between nations without any barriers appear.⁴³ Still, there will be a consequence of the

³⁷ *Ibid.*

³⁸ Joost Pauwelyn, *Op. Cit.*, pp. 536-537.

³⁹ Nancy Kontou, "The Termination and Revision of Treaties In The Lack of New Customary International Law", 21, 1994, (stating that "it is accepted that the binding force of conventional and customary rules is the same").

⁴⁰ Joost Pauwelyn, *Op. Cit.*, p. 538.

⁴¹ The WTO, *Understanding the WTO*, Fifth Edition, (World Trade Organization: 2015), 9.

⁴² Hata, *Hukum Ekonomi Internasional 'IMF, World Bank, WTO'*, (Malang: Setara Press, 2016) 119; Charles E. Ochem and Abiola O. Oyewo, "The World Trade Organization: Implications On Global Economy", *Global Journal of Politics and Law Research*, Vol.3, No.6 (2015): 28.

⁴³ Nandang Sutrisno, "Memperkuat Sistem Hukum Remedi Perdagangan, Melindungi Industri Dalam Negeri", *Jurnal Hukum* No. 2 Vol. 14 April 2007, p. 234, available on: <https://media.neliti.com/media/publications/85149-none-2739ec46.pdf>, accessed on March 6, 2020.

liberalization of trade, which is the appearance of unfair trade practices⁴⁴ that will be conducted by many legal subjects, and create unfair competition in WTO, while WTO only supports open, fair and undistorted competition.⁴⁵

Currently, WTO becomes the leading role in the international trade system,⁴⁶ by settling cases related to domestic and imported products which breaches the national treatment principle,⁴⁷ not only about national treatment, but the problem also about the anti-dumping and subsidy, which will be discussed in the next phase. Before going further, better if we understand the principles that applied under WTO. The three most fundamental principles that used under WTO are Most-Favoured Nation (MFN), national treatment, and transparency.⁴⁸ MFN establishes that every member state who participate in the international trade must eliminate the discrimination act on conducting to one state and another state,⁴⁹ by means, every state must treat another member state equally on the matter of tariff, duties, charges, etc.⁵⁰ National treatment established to prohibits any discrimination between domestic products and imported products on the matter of laws, taxes, internal charges, regulations, etc.⁵¹ Then, the principle of transparency has the aim to guarantees the openness of governmental regulations that in this

⁴⁴ Neeti Shikha, "Competition and The WTO – A Dead End", *Ankara Law Review*, Vol. 7, No. 2, Winter (2010): 93.

⁴⁵ Hata, *Op.Cit.*, p. 124.

⁴⁶ Anastasia S. Loginova, Irina V. Mikheeva, "The Impact of WTO Membership: A Comparative Analysis of China, Russia, and Ukraine", *Routledge*, New York (2017) the page is not written.

⁴⁷ Siqing Li, "Convergence of WTO Dispute Settlement and Investor-State Arbitration: A Closer Look at Umbrella Clauses", *Chicago Journal of International Law*, Vol. 19 No. 1: Article 6, (2018): 192.

⁴⁸ Mitsuo Matsushita, "Basic Principles of the WTO and the Role of Competition Policy", 3 *Wash. U. Global Stud. L. Rev.* 363 (2004): 363.

⁴⁹ *Ibid.*

⁵⁰ Article I (1) of the GATT (General Agreement on Tariffs and Trades) 1994.

⁵¹ UNCTAD, "Dispute Settlement 'World Trade Organization 3.5 GATT 1994'", *United Nations*, (2003): 19.

manner will help to keep up the predictability for traders in the international field.⁵² Thus, WTO had these important principles are for fair and non-discriminatory competition between states.

After understanding the basics of WTO and its principle, then this part will explain a bit about the trade remedies, as written above, WTO is applying the liberal trade system, and under this system there will be consequences that will arise, especially the implementation of unfair trade practices by the business actor. To face this kind of consequences, there is a need on making trade protection measure to prevent any threats toward national and international trade, and one of the measure is through trade remedies.⁵³ Trade remedy measures generally refers to anti-dumping and anti-subsidies (countervailing duties), that use by many importer Members State to protect their domestic industries.⁵⁴ Anti-dumping targets the unfair competition conducted by private company, and anti-subsidy targets unfair competition that caused by the subsidies that given by the exporter's government.⁵⁵ Trade remedies used to anticipate dumping and subsidy products through the implementation of import-duty, for the anti-subsidy the import duty is called as the countervailing duties. Countervailing duties aim to anticipate subsidies from foreign government towards their company, production or any kind of export activities.⁵⁶

⁵² Mitsuo Matsushita, *Op. Cit.*, p. 364.

⁵³ Wentong Zheng, "Reforming Trade Remedies", 34 *MICH. J. INT'L L.*, (2012): 153, available at: <https://repository.law.umich.edu/mjil/vol34/iss1/3> , accessed on July 28, 2020.

⁵⁴ Nandang Sutrisno, *Op. Cit.*, p. 231.

⁵⁵ Nandang Sutrisno, *Op. Cit.*, p. 236.

⁵⁶ *Ibid.*

Under the WTO, there is a regulation that is specifically ruling about the countervailing measures as the form of trade remedies for subsidy and surely about the subsidies itself, for the countervailing measure will be explained in the next chapter. In the Agreement on Subsidies and Countervailing Measures (further called as SCM Agreement) defines subsidies as a financial contribution given by the government or any public body within the territory of the member state, which it creates benefit, or in a more specific sentence as said in the Agreement:

“Subsidies in terms of the agreement are:

- (1) financial contributions granted by governments or any other public bodies, including subnational government entities, if these contributions involve: (i) the direct transfer of funds through grants, loans, equity infusion, or potential transfers like loan guarantees; (ii) foregone government revenue due to tax credits or other fiscal incentives; (iii) the provision of goods and services other than general infrastructure; (iv) government payments to a funding mechanism that carries out one or more of the functions illustrated in (i) to (iii) above.
- (2) any form of income or price support.”⁵⁷

Then, based on Muhammad Sood, subsidies could be referred to as aid or incentives given by the government to the economic actors in their homeland,⁵⁸ the aid could be in the form of import tariffs aids; aid on low interest on bank credit; aid on incentives in the form of money to the export producer; aid on research expenses and technology development.⁵⁹ Based on Simon Lester’s journal, he quoted from Paul A Samuelson and William D Nordhaus, that subsidies have been defined broadly as ‘[a] payment by a government to a firm or household that provides or consumes a commodity’.⁶⁰ Then, from the opinion of John H. Jackson, that the issues of subsidies and countervailing duties are more significantly

⁵⁷ Article 1(1) of Agreement on Subsidies and Countervailing Measures.

⁵⁸ Muhammad Sood, *Hukum Perdagangan Internasional*, (Rajawali Press, 2011), p. 189.

⁵⁹ *Ibid.*

⁶⁰ Simon Lester, “The Problem of Subsidies As A Means of Protectionism: Lessons From The WTO EC — Aircraft Case”, *Melbourne Journal of International Law*, Vol.12 (2011): 4.

involving the high level of government rather than the other trade policy matters, and by this, it makes the issues more visible,⁶¹ because the government had been seen clearly that they gave aid to the company.

The purpose of giving subsidies based on A. F. Elly Elawati is two, first, the subsidies will push the growth of export, by means the producer will be able to decrease its production cost since there are subsidies that accepted, and the result, the market will be more competitive because the product is cheaper than the others. Second, subsidies will decrease import, because giving subsidies to the local business actor will help them to not accept the components of their product outshore.⁶² Subsidies are giving many benefits for company or producer, but if the subsidies are in the term of "too much", there will be unfair business action, since not every company or producer receiving the same amount of subsidies, while it will affect the cost of production and resulting in a very competitive price with the company that not receiving subsidies. Therefore, the appearance of subsidies regulation will be able to decrease the case of unfair business practices.

Many experts were referred the subsidies as the "traffic light approach",⁶³ the "red-light" subsidies are prohibited almost entirely, the "green-light" subsidies are the ones who get the permissible class, and the "yellow-light" subsidies are only actionable but depending on their effects on the free trade:⁶⁴

a. Actionable Subsidies

⁶¹ John H. Jackson, *Op. Cit*, p. 250.

⁶² Muhammad Sood, *Op. Cit*, pp. 190-191.

⁶³ Jeffrey D. Kienstra, *Op. Cit*, p. 583.

⁶⁴ Meier-Kaienburg, *Op. Cit*, p. 203.

Based on the SCM Agreement article 5, actionable subsidies as the use of any subsidy by the member state that causes adverse effects to the other member state.

The adverse effect explains:

- “(a) injury to the domestic industry of another Member¹;
- (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994, in particular, the benefits of concessions bound under Article II of GATT 1994;
- (c) serious prejudice to the interests of another Member.”⁶⁵

Muhammad Sood defines actionable subsidies as subsidies that have the possibility to get sanction if causing injury and threat of injury for the domestic industry from the importer countries, and if the subsidies remove or harm the profits directly or indirectly, while usually the profits were received by the other country.⁶⁶ In the simple word, as explained by Meier Kaeinberg, 'subsidies are "actionable" when they cause "adverse effects" on free trade'.

Based on Jurgen Stehn, actionable subsidies are "specific" subsidies that cause "adverse effects to the interests of other members" by nullifying or impairing the advantages under the GATT, injuring their domestic industry ("material injury") or causing them serious prejudice.⁶⁷ Nullifying or impairing the profits that received by WTO member as mentioned in the Article 5(b) of SCM Agreement will affecting the tariff concessions that mentioned under the Article II(1) of GATT 1994.⁶⁸ According to Simon Lester, the case of Airbus-Boeing is mostly alleging

⁶⁵ Article 5 of Agreement on Subsidies and Countervailing Measures.

⁶⁶ Muhammad Sood, *Op. Cit.*, p. 197.

⁶⁷ Jurgen Stehn, "Subsidies, countervailing duties, and the WTO: towards an open subsidy club", *Kiel. - Kiel: Inst. fur Weltwirtschaft*, (1996): 6.

⁶⁸ Peter van de Bossche, Daniar Natakusuman, and Joseph Wira Koesnaidi, *Pengantar Hukum WTO (World Trade Organization)*, (Jakarta: Yayasan Obor Indonesia, 2010) p. 47.

about illegal subsidies under the category of actionable subsidies, to dig deeper about the core of the case, then we still need to define what is subsidies within its traffic light approach.⁶⁹

Incase the Panel or Appellate Body find that there are adverse effects on the subsidies to the other WTO member, therefore the member who gives the subsidies shall,⁷⁰ based on article 7 of the SCM Agreement:

- 1) Take appropriate measures to eliminate the adverse effects, or
- 2) Takedown the subsidies.

b. Non-actionable Subsidies

The provision that concerns on the non-actionable subsidies was expired five years after the SCM Agreement came into force,⁷¹ but as to be added as additional information, based on Article 8 of the SCM Agreement, non-actionable subsidies consist of:

- 1) Subsidies which are not specific within the meaning of Article 2;
- 2) Subsidies which used for research aids to help companies, universities, research centers, as long as the aids are no more than 75% from the cost of industrial research.⁷² Then to help financial assistance for poor regions, and certain environmental protection programs.⁷³

⁶⁹ Meier-Kaienburg, *Op. Cit.*, pp. 203-204.

⁷⁰ *Ibid*, p. 48.

⁷¹ Simon Lester, *Op. Cit.*, p.10.

⁷² Article 8 of Agreement on Subsidies and Countervailing Measures; *Op. Cit*, Muhammad Sood, p. 197.

⁷³ Simon Lester, *Loc. Cit.*

c. Prohibited Subsidies

The main problem that discussed under this thesis is regarding the prohibited subsidies because in the summary of the case EU submit a complaint that subsidies granted allegedly by the US government had violated article 3.1(a) of SCM Agreement regarding prohibited subsidies – export subsidies.⁷⁴ Firstly we have to understand what is the meaning of prohibited subsidies. From the article written by Simon Lester, he defines that there are two types of prohibited subsidies, which are export subsidies and domestic content subsidies:⁷⁵

1. Export Subsidies are subsidies that are ‘contingent, in law or fact, whether solely or as one of several other conditions, upon export performance’.⁷⁶ The export subsidies also fall as the prohibited subsidies or referred to as the "red-light".⁷⁷ These prohibited subsidies are not available for countries that categorized as least developed countries, and for the developing countries counted 8 years after the SCM Agreement entry into force.⁷⁸ SCM Agreement provides the illustrative list of export subsidies as “provision by governments of direct subsidies to a firm or an industry contingent upon export performance”.⁷⁹
2. Domestic content subsidies are defined as subsidies that are ‘contingent, whether solely or as one of several other conditions, upon the use of

⁷⁴ *US — Large Civil Aircraft (2nd Complaint) Summary of Case, Op. Cit.*

⁷⁵ Article 3.1(a) of Agreement on Subsidies and Countervailing Measures; Simon Lester, *Op. Cit.*, p. 7.

⁷⁶ *Ibid*, article 3.1(a).

⁷⁷ Jeffrey D. Kienstra, *Op. Cit.*, p. 583.

⁷⁸ Muhammad Sood, *Op. Cit.*, p. 196.

⁷⁹ Annex I (a) of Agreement on Subsidies and Countervailing Measures.

domestic over imported goods'.⁸⁰ In simple words, these subsidies will prefer local products rather than imported products.⁸¹

The clear difference between export and domestic subsidies is about their position, the export subsidies known as the illegal subsidies that cause the injury, while domestic subsidies are known as legal subsidies which probably will be injured.⁸² In this research thesis, the export subsidies will be used more as it is defining the prohibited or illegal subsidies.

By that, all the literature reviews above will be use for the writer to analyze and answer the issues that proposed and more likely able to give good sources for those who need this research paper for their academic study.

F. Research Methods

This research was conducted with the specifications as follow:

1. Type of Research

This research was normative legal research. Normative legal research or also called legal research literature is legal research carried out in a way researching the library materials or secondary sources.⁸³ The method of normative legal research used in this research was through research object, legal materials or sources of data, method of collecting materials, research approach and processing data analysis, which all of them are explained below.

⁸⁰ Article 3.1(b) of Agreement on Subsidies and Countervailing Measures; Simon Lester, *Op. Cit.*, pp. 8-9.

⁸¹ Muhammad Sood, *Op. Cit.*, p. 197.

⁸² Jurgen Stehn, *Op. Cit.*, p. 5.

⁸³ Soerjono Soekanto and Sri Mamudji, *Penelitian Hukum Normatif: Suatu Tinjauan Singkat*, (Jakarta: Rajawali Press, 2009), 13-14.

2. Focus of Research

This research focused on analyzing the subsidies received by Boeing from the United States, and why the subsidies categorized as prohibited subsidies as alleged by the European Communities on case number DS353 *US — Large Civil Aircraft (2nd Complaint)* of WTO Dispute Settlement Body.

3. Research Approach

The research approach used in this research are:

a. Statutory approach

The statutory approach uses the statute or some regulations to answer the problem that arised.⁸⁴ This approach is to analyze the rule or regulations or international agreement that related to the case of Boeing and Airbus, also to understand the subsidies as the core of the problem in this thesis research. The writer used some statutory, which are:

- 1) General Agreement on Tariffs and Trade 1994;
- 2) Agreement on Subsidies and Countervailing Measures; and
- 3) DS353 *US — Large Civil Aircraft (2nd Complaint)* documents of WTO Dispute Settlement Body.

b. Conceptual approach

⁸⁴ Johni Ibrahim, *Teori dan Metodologi Penelitian Hukum Normative*, 3rd Edition, (Bayubedia Publishing. 2007), 3.

Conceptual approach uses views and doctrines that develop in law.⁸⁵ The doctrines related to this research was used to write this thesis, and thus, it gave the writer a deep understanding of the problem brought in this thesis.

4. Sources of Research Data

Within this research, the legal materials that used in this thesis research are primary legal materials, secondary legal materials, and tertiary legal materials.

a. Primary legal materials

Primary legal materials are legally binding in terms of juridical manners⁸⁶ that related to the object of research, including:

- 1) General Agreement on Tariffs and Trade 1994;
- 2) Agreement on Subsidies and Countervailing Measures; and
- 3) DS353 US — *Large Civil Aircraft (2nd Complaint)* documents of WTO Dispute Settlement Body.

b. Secondary Legal Materials

Secondary legal materials are the legal materials to support and provide more explanation to complete the primary legal materials.⁸⁷

In this research, the secondary legal materials that used are books, literature, scientific journals, and internet sites.

c. Tertiary legal materials

⁸⁵ Soerjono Soekanto and Sri Mamudji, *Op. Cit.*, 13-14.

⁸⁶ Soerjono Soekanto, *Penelitian Hukum Normatif: Suatu Tinjauan Singkat*, (Jakarta: Rajawali, 1998), 10.

⁸⁷ *Ibid.*

Tertiary legal materials are the legal materials that used to support and provide more explanation for the primary legal materials and secondary legal materials⁸⁸ if the previous material still gives uncertainty to the writer. Then, in this research, the tertiary legal materials used are Black's Law Dictionary and encyclopedias.

d. Data collection techniques

The techniques used in this research were through literature study and study documents related to research focus.

5. Data Analysis

The data analysis process during the research of this thesis used the qualitative data analysis. The process was done by describing the data from documents of cases, laws, and regulations, experts, doctrines, and the researcher's argument.

G. Systematic of Writing

Systematic in this writing were divided into four chapters, and there was correlation in every chapter. The systematic of writing are as follows:

Chapter I Introduction

This chapter contains the background of the problem, formulation of the problem, purpose of the study, research originality, literature review, research methods and systematic writing as a guideline to create an understanding of the contents of this study.

⁸⁸ Soerjono Soekanto, *Op. Cit.*, p. 16.

Chapter II General Overview of Subsidy and SCM Agreement

This chapter contains the literature review that will define the theories that guide the writer to answer the problem that proposed. This chapter consists of another sub-chapter, in sub-chapter A discuss about the history of GATT/WTO related to the appearance of subsidy regulation, the principles of WTO and the authority of WTO. Sub-chapter B discuss about the subsidy, from the definition, the actionables and prohibited subsidies, export and import subsidies, and the international regulation that mandated to regulate those matter. Then, in sub-chapter C discuss about the islamic perspective of international trade.

Chapter III Analysis on Subsidy Control under WTO and The Prohibited Subsidies from The U.S Government for Boeing LCA.

This chapter consists of the analysis on how WTO controls the subsidy under the SCM Agreement, and the reasons why the subsidies were provided by the U.S government for Boeing LCA categorized as prohibited subsidies.

Chapter IV Conclusions and Recommendations.

This chapter contains conclusions from the results of the analysis process conducted by the writer in regards of the researched case, and also the writer's recommendations relate to the case.

CHAPTER II

GENERAL OVERVIEW OF SUBSIDY AND SCM AGREEMENT

A. Development of World Trade Organization

1. History of World Trade Organization

World Trade Organization (WTO) was created from the willingness of states to have a proper and lawful international trade, but before World Trade Organization (WTO) appears there were many of stories occurred. The very first organization to do a global trade was International Trade Organization (ITO) alongside with ITO Charter as its guidelines,¹ the forming of ITO itself was coming after the founding of United Nations in 1945, as one of their framework on trade, the Economic and Social Council of United Nations, which in 1946 adopted a resolution to form an International Trade Organization.² In the regime of ITO, the objectives of the organization was (1) draft an ITO Charter; (2) prepare schedule for tariffs and reduction and, (3) prepare a multilateral treaty containing general principles of trade, namely, the General Agreement on Tariffs and Trade (GATT).³ The appearance of ITO Charter was rejected by the US Congress, and that was the end of International Trade Organization. Then in 1947, General Agreement on Tariffs and Trade (GATT) created as the temporary organization to conduct international

¹ Craig VanGrasstek, *The History and Future of the World Trade Organization*, (WTO Publications, 2013), 10 available at https://www.wto.org/english/res_e/booksp_e/historywto_e.pdf accessed on March 12, 2020.

² Mitsuo Matsushita, et. al., "The World Trade Organization: Law, Practice, and Policy, Second Edition", *Oxford University Press*, October, 2005, pp. 1-2.

³ *Ibid*, p. 2.

trade,⁴ the GATT treaty creates a set of rules to govern trade among 23 member countries rather than a formal institution.⁵ While GATT fills the task of ITO, GATT still held the meeting every year, and new members gradually added,⁶ and over in 40 years with the grew number of members, GATT succeed on reducing barriers to trade.⁷ GATT members gradually met in what came to be known as *Negotiating Rounds*. The various negotiating rounds were named according to the place where the negotiation took place, and the negotiating rounds were:⁸

- 
- 1) Geneva Rounds (1947)
 - 2) Annecy Rounds (1949)
 - 3) Torquay Rounds (1950)
 - 4) Geneva Rounds (1956)
 - 5) Dillon Rounds (1960-1961)
 - 6) Kennedy Rounds (1962-1967)
 - 7) Tokyo Rounds (1973-1979)
 - 8) Uruguay Rounds (1986-1994)

The first try to reform the system of WTO was discussed on Tokyo Rounds, where the subsidy and countervailing measures also started and written under the what so called as Tokyo Rounds “Subsidy Code”.⁹ In that rounds new problem

⁴ Craig VanGrasstek, *Loc. Cit.*

⁵ Meredith A. Crowley, “An introduction to the WTO and GATT”, *Economic Perspectives*, Federal Reserve Bank of Chicago, 4Q, 2003, p. 43.

⁶ Mitsuo Matsushita, et. al., *Op. Cit*, p. 3.

⁷ Meredith A. Crowley, *Loc. Cit.*

⁸ Mitsuo Matsushita, et. al., *Op. Cit*, p. 6.

⁹ The WTO, *Understanding the WTO*, fifth edition, (World Trade Organization Information and External Relations Division, WTO, 2015), p. 16, available at: (<http://www.wto.org>, click on “About WTO”), accessed on February 25, 2020. [The WTO ‘fifth edition’]

was arose, and the achievements were not satisfying, then the GATT members initiated for another effort through the Uruguay Rounds in 1980s, where there was 15 subjects being discussed including the subsidies.¹⁰

In the 1980s, despite of the GATT success, several problem was arised, especially on the matter of dispute settlement, because in practical, the dispute settlement was not working effectively as what it had been hoped before.¹¹ Then, to discuss the problem, GATT held Uruguay Rounds which the goals were far more ambitious rather than the previous rounds, the negotiating rounds was sought to introduce major reforms into how the world trading system would function.¹² Uruguay Rounds at the end transformed GATT into a true international organization where the laws applied effectively and enforced by a stronger dispute settlement mechanism that called as World Trade Organization (WTO) through the Act signed in Marrakesh, Morocco on 15 April 1994.¹³

2. Understanding about WTO

WTO was coincided establish at the end of the Cold War, and became the organization which have the opportunity to spread peace and reduce burdens for states, and bring the world system being cooperative.¹⁴ Based on the public international lawyers, WTO rules considered as rules of public international law, and the rules regulate the trade relation between states.¹⁵ WTO was assisting the implementation and operation of what have been discussed under the Uruguay

¹⁰ The WTO 'fifth edition', *Op. Cit.*, pp. 17-18.

¹¹ Mitsuo Matsushita, et. al, *Op. Cit.*

¹² Meredith A. Crowley, *Op. Cit*, p. 44.

¹³ Craig VanGrasstek, *Op. Cit*, p. 11; Mitsuo Matsushita, et. al, *Loc. Cit.*

¹⁴ *Ibid*, Craig VanGrasstek.

¹⁵ Joost Pauwelyn, *Op. Cit*, pp. 538-539

Rounds, such as its plurilateral agreement and the 15 original subjects which consist of: Tariffs, Non-tariff barriers, Natural resource products, Textiles and clothing, Agriculture, Tropical products, GATT articles, Tokyo Round codes, Anti-dumping, Subsidies, Intellectual property, Investment measures, Dispute settlement, The GATT system and Services,¹⁶ which through the collaboration with International Monetary Fund (IMF) and International Bank for Reconstructions and Development (IBRD).¹⁷ The WTO and its predecessor (GATT) in the past 50 years had successfully reducing tariff and other trade barriers among nations.¹⁸ The importance of WTO simply written in Charles E. Ochem and Abiola O. Oyewo's article, which says:

“The creation of the WTO represented a significant step towards a more integrated and thus more dynamic international trading system. By ensuring that countries keep up the momentum of dismantling barriers to trade in subsequent trade talks, the WTO also secured the continuous promotion of free trade. With two thirds of its members composed of developing countries, the organization also offers transition economies and least developed countries (LDCs) the possibility of employing trade to advance their development efforts.”¹⁹

Therefore, as the international organization majoring in trade, WTO has the big impact for the development of international trade, and all nation around the world has the legal institution to keep the international trade in a just way.

3. The Scope of WTO

¹⁶ The WTO 'fifth edition', *Op. Cit*, p. 18.

¹⁷ Thor B. Sinaga, "Efektifitas Peran dan Fungsi Wto (*World Trade Organization*) Dalam Penyelesaian Sengketa Perdagangan Internasional", *Lex et Societatis*, Vol. II/No. 8/Sep-Nov/2014, p. 120.

¹⁸ Charles E. Ochem and Abiola O. Oyewo, "The World Trade Organization: Implications On Global Economy", *Global Journal of Politics and Law Research*, Vol.3, No.6, European Centre for Research Training and Development, UK, December (2015), p. 29.

¹⁹ *Ibid.*

As mentioned under the *Agreement Establishing The World Trade Organization* or known as the *Marrakesh Agreement*, which is to provide the common institutional framework for the conduct of trade relations that associated with the agreements and legal instruments²⁰ that consist of²¹:

- 1) GATT 1947
- 2) GATT 1994 (Annex 1A)
- 3) Multilateral Agreements on Trade in Goods (Annex 1A)
- 4) General Agreement on Trade in Services and Annexes (Annex 1B)
- 5) Agreement on Trade-Related Aspects of Intellectual Property Rights (Annex 1C)
- 6) Disputes Settlement Understanding (Annex 2)
- 7) Trade Policy Review Mechanism (Annex 3)
- 8) Plurilateral Trade Agreements (Annex 4)

4. The Principles of WTO

As a international organization which majoring at the international trade, WTO adopts several principles as the foundation to conduct the multilateral trading system, and the principles are:

- a. Most Favoured Nations (MFN)

In the simple word, this principle means treating other people equally, but in the scope of WTO, MFN is a principles that requires all member

²⁰ Article II (1), Agreement Establishing The World Trade Organization.

²¹ Article II & List of Annexes, Agreement Establishing The World Trade Organization.

states to give the same treatment to the other member states as all the member states are equally “most favoured” trading allies.²² This principle appears to guarantee equal competitive conditions between goods and services from every member states.²³ Most Favoured Nations principle also stipulate in the Article I of GATT 1994²⁴, and the article was mean to prevent the member states to make discriminatory domestic policies where it will disrupt the fair competition between domestic and imported products.²⁵

b. National Treatment

National treatment principle written under the Article III of GATT 1994,²⁶ and this principle meant to manage a fair competition between domestic product and enterprises or even between the member states.²⁷ This rule prevents countries from taking discriminatory measures on imports and protect equality of competitive in principle.²⁸

National treatment principle according to GATT 1994 have the aim to respect to all laws, regulations, and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of imported

²² M. Saqib Irshad, et. al, “The Role of Charismatic World Trade Organization and the expansion of Free International Trade”, *International Journal of Management Science and Business Administration* Volume 2, Issue 3, February 2016, p. 19, available at: <https://www.researchgate.net/publication/299249552> , accessed on April 15, 2020.

²³ Mitsuo Matsushita, et. al., *Op. Cit*, p. 367.

²⁴ Article I, GATT 1994.

²⁵ Robert Howse, “The World Trade Organization 20 Years On: Global Governance by Judiciary”, *The European Journal of International Law*, Vol. 27 no. 1, Oxford University Press, (2016), p. 14, available at: <https://academic.oup.com/ejil/article/27/1/9/2756327> , accessed on April 20, 2020.

²⁶ Article III, GATT 1994.

²⁷ Mitsuo Matsushita, et. al., *Op. Cit*, p. 366.

²⁸ Robert Howse, *Op. Cit*, p. 47.

goods.²⁹ On the other hand its also written in in Article XVII of the GATS and Article Three of the TRIPs Agreement.³⁰ In simple word, this principle appears to give equality between the domestic products and foreign “like” products.

c. Transparency

The two-part requirements of transparency is also became the foundation of the WTO. The first part is the commitment forced on Members of the WTO to distribute or make openly accessible for every single regulations before application, as the requirement of impartial administration for such regulations for being reviewed. The second part is the requirement that Members state give notice for governmental activities or actions to the WTO and the Members.³¹ GATS says governments must publish all relevant laws and regulations, and set up enquiry points within their bureaucracies.³²

The principle of transparency is written in Article X of the GATT 1994, Article III of the GATS and Article Sixty-three of the TRIPs Agreements. This principle fills in as the reason for a rule-oriented foreign trade policy and for keeping up security and consistency of the trade law regulations of the members.³³ In the simple words the principle of transparency is a

²⁹ Article III.4, GATT 1994.

³⁰ Mitsuo Matsushita, et. al., *Loc. Cit.*

³¹ Mitsuo Matsushita, et. al., *Op. Cit.*, p. 368.

³² The WTO, *Op. Cit.*, p. 35.

³³ *Ibid.*

principle to maintain that negotiations and process must be fair and open with rules equal for all.³⁴

d. Fairness

The principle of fairness is a principle created to prevent a country from receiving certain benefits by carrying out certain policies, while on the other hand these policies actually cause harm. In international trade, this principle is directed at eliminating fraudulent competitive practices in trade practices called dumping practices and subsidies in international trade.

Dumping and subsidies are acts that are strictly prohibited by in international trade. Therefore, to avoid these fraudulent practices, the WTO determines that if a country is proven to have carried out such practices, then the importing country that is harmed by that practice has the right to impose a counter sanction. This counter sanction can be in the form of an additional import duty called "anti-dumping import duty" which is imposed on products that are exported by dumping and countervailing duties.³⁵

e. Reciprocity

The principle of reciprocity is one of the important principles of the WTO, it is clearly written in the preamble of the GATT 1994.³⁶ This

³⁴ M. Saqib Irshad, et. al., *Loc. Cit.*

³⁵ Muhammad Sood, *Op. Cit.*, p. 48.

³⁶ The preamble says: "*Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce,*"

principle requires reciprocal treatment among fellow WTO member countries in international trade policy or in other words this principle wants nations try to provide similar concessions for each other.³⁷ That is, if there is a country in its international trade policy to reduce import tariffs on imported products from a country, the exporting country of the product must also reduce the entry tariff for products from the first country. Based on this principle, it is expected that each country will reciprocally facilitate each other for goods and service traffic. Thus, it is hoped that each country will enjoy the results of international trade fluently and freely.³⁸

5. The Role of WTO

As the appearance of WTO as the multilateral organization, it shall has better roles rather than its predecessor (GATT), and the roles of WTO consist of:³⁹

- a) Administer various agreements resulting from the Uruguay round in the field of goods and services, both multilateral and plurilateral, as well as oversee the implementation of market access commitments in the tariff and non-tariff fields.⁴⁰
- b) Controls international trade practices by regularly reviewing the trade policies of member countries and controls through the notification procedures.⁴¹

³⁷ M. Saqib Irshad, et. al., *Loc. Cit.*

³⁸ Muhammad Sood, *Op. Cit.*, p. 45.

³⁹ Thor B. Sinaga, *Loc. Cit.*

⁴⁰ Charles Barnor, et. al, "The Role and Functions of the International Trade Organization (ITO) and the World Trade Organization (WTO): The Major Differences and Similarities", *International Journal of Sciences: Basic and Applied Research (IJSBAR)*, Volume 24, No 6 (2015): 95.

⁴¹ Thor B. Sinaga, *Loc. Cit.*

- c) As a forum for resolving disputes and providing conciliation mechanisms to resolve trade disputes that arise.⁴²
- d) Provide technical assistance needed for its members, including developing countries and especially the least developed countries to ensure their economic growth within the international trade area.⁴³
- e) As a forum for members of their countries to continuously negotiate exchange of concessions in the trade sector to reduce barriers in international trade area.⁴⁴
- f) Consultancy services, means that the WTO keeps a watch on the development in the World economy and it provides consultancy services to its member nations.
- g) The WTO also have role to assists IMF and IBRD for establishing balance environemnt in universal economic policy administration.
- h) The WTO also has function as a code of conduct for international trade,⁴⁵ because without the appearance of WTO, the international trade practices will only full with unfair competition.

B. Subsidies in WTO

Subsidies have become one of the most important part for industrial policy matter in recent years, especially for the purpose of promoting high-technology industries,⁴⁶ such as aircraft. As the history of WTO, from the ITO era to GATT,

⁴² Charles Barnor, et. al, *Op. Cit*, p. 96.

⁴³ Agreement Establishing The World Trade Organization, preamble 2.

⁴⁴ Charles Barnor, et. al, *Op. Cit*, p. 95.

⁴⁵ Charles Barnor, et. al, *Op. Cit*, p. 96.

⁴⁶ Jurgen Stehn, *Op. Cit*, p. 3.

until the creation of WTO, subsidy became one of the topic that discussed, from the regulation that called as “Subsidy Code” in Tokyo Round, until it recently called as The Agreement of Subsidies and Countervailing Measures “SCM Agreement”. The SCM agreement has the aim to discipline the use of subsidy, and regulates the actions countries can take to counter the effects of subsidies.⁴⁷

The SCM agreement addresses two main topic: multilateral disciplines regulating the provision of subsidies, and the use of countervailing measures to offset injury caused by subsidized imports.⁴⁸ Then, in detail, the agreement contains a definition of subsidy, and also introduces the concept of a “specific” subsidy, i.e. a subsidy available only to an enterprise, industry, group of enterprises, or group of industries within the country (or state, etc) that provides the subsidy. The agreement also defines two categories of subsidies, prohibited and actionable. Previously there was third category that called as the non-actionable subsidies, and it was existed for five years, which ending on 31 December 1999, and wasn't extended.⁴⁹

1. Evolution of Subsidy Rules in GATT/WTO

⁴⁷ WTO, “Subsidies and countervailing measures”, Official Website of WTO, available at: https://www.wto.org/english/tratop_e/scm_e/scm_e.htm , accessed on April 22, 2020, also cited “under the Agreement of Subsidies and Countervailing Measures a country can use the WTO’s dispute-settlement procedure to seek the withdrawal of the subsidy or the removal of its adverse effects. Or the country can launch its own investigation and ultimately charge extra duty (“countervailing duty”) on subsidized imports that are found to be hurting domestic producers.”

⁴⁸ Jan Jakub Michalek, “Subsidies in the context of the World Trade Organization”, *Dans Reflets et perspectives de la vie économique* 2004/1 (Tome XLIII), available at: <https://www.cairn.info/revue-reflets-et-perspectives-de-la-vie-economique-2004-1-page-25.htm#> , accessed on April 22, 2020.

⁴⁹ WTO, “Understanding The WTO: The Agreements ‘Anti-dumping, subsidies, safeguards: contingencies, etc’”, Official Website of WTO, available at: https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm , accessed on April 22, 2020; The WTO “Understanding the WTO” Fifth Edition, *Op. Cit*, p. 45.

a. GATT Article XVI

In the early years of GATT, however, the subsidy rules, which were contained in Article XVI, were neither well developed nor imposing. The entirety about the first multilateral subsidy discipline was written in Paragraph 1 of Article XVI of the GATT, which was taken from the Havana Charter of ITO. All Paragraph 1 required was that signatories should notify “any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory...”.⁵⁰ The notification was required to specify the extent and nature of the subsidization, its estimated effects on exports and imports, and the circumstances making the subsidization necessary.⁵¹

Article XVI draws two basic distinctions, one between domestic and export subsidies and another between primary (agriculture) and nonprimary export subsidies, where the domestic subsidies being the most important instrument of national economic policy since it gives minor negative trade effects, meanwhile, the export subsidies judged as the evil instrument because they are likely to lead to bring conflict in international relations, thus the article certainly prohibits all subsidies that reduce the value of nonprimary exports, but gives the green light for domestic subsidies.⁵² The second distinction of “that between primary and nonprimary export subsidies” was based on political reality, not on economic

⁵⁰ Article XVI (1), GATT 1994.

⁵¹ WTO, “Exploring the links between subsidies, trade and the WTO”, *World Trade Report* (2006): p. 190, available at: https://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report06_e.pdf, accessed on April 22, 2020. Here in after written as “World Trade Report 2006”.

⁵² Jurgen Stehn, *Loc. Cit.*

principles of the member states, because all major industrial countries were running from a huge farm subsidy program.⁵³ Simply, the agreement recognized that domestic subsidies are important for the sake of promotion on social and economic policy, and the agreement prohibited export subsidy but permitted domestic subsidy.⁵⁴

This unjust treatment of subsidies on primary and non-primary products reflected the interests of dominant GATT contracting parties at the time,⁵⁵ not only that, in the GATT Article XVI was failed to make the link between the subsidies and the countervailing duties that written under the Article VI,⁵⁶ therefore, to avoid further problem, the rule of subsidy being discussed again in the Tokyo Round.

b. The Tokyo Round Agreement “*Subsidies Code*”

In the era of Tokyo Round, the agreement of subsidies was made and called as The Subsidies and Countervailing Duty Code of 1979 “Subsidies Code”, the Code contains about the Agreement on Interpretation and Application of Articles VI, XVI and XXXIII of GATT, and entered into force on 1 January 1980.⁵⁷ The Code was tried to achieve the objectives on, first, the imposition of countervailing duties, and second, surely about the use of subsidies.⁵⁸ The Code recognized that “subsidies are used by government to promote important objectives of national policy” and also recognized that “subsidies may have harmful effects on trade and

⁵³ *Ibid.*

⁵⁴ Jeffrey D. Kienstra, *Op. Cit.*, p. 579.

⁵⁵ World Trade Report 2006, *Loc. Cit.*

⁵⁶ Jurgen Stehn, *Loc. Cit.*

⁵⁷ World Trade Report 2006, *Loc. Cit.*; twenty-four countries ratified the Code. Some of these did so with reservations and exceptions.

⁵⁸ *Ibid.*

production”,⁵⁹ therefore, the Code also emphasized its goal to “ensure that the use of subsidies does not adversely affect or prejudice the interests of any signatory to this Agreement”.⁶⁰

In the Subsidies Code, it emphasized the prohibition of export subsidies on non-primary products, and which excluded mineral products. The Code also elaborated about certain rules linked with adverse effects, and contained special and differential treatment (S&D) provisions for developing country signatories.⁶¹ The special thing about Subsidies Code is on its detailed dispute settlement mechanism.⁶²

c. The Uruguay Round Agreements relevant to the Agreement on Subsidies and Countervailing Measures

The appearance of Agreement on Subsidies and Countervailing Measures (SCM Agreement) is a symbol of the improvement of GATT on dealing with “Subsidies”,⁶³ but the SCM Agreement was not built for the civil aircraft industry only, it was built as “the WTO’s ‘generic agreement regarding subsidies’”.⁶⁴

The SCM Agreement was able to reach the goal on Tokyo Round, on defining the term of “Subsidies”,⁶⁵ and divided subsidies into three categories, known as the

⁵⁹ Tokyo Round Subsidies Code, Preamble 2 & 3.

⁶⁰ Tokyo Round Subsidies Code, *Op. Cit*, Preamble 5.

⁶¹ World Trade Report 2006, *Op. Cit*, p. 191.

⁶² Jurgen Stehn, *Op. Cit*, p. 5.

⁶³ Jeffrey D. Kienstra, *Op. Cit*, p. 583.

⁶⁴ Marc C. Mathis, “Uncivil Aviation: How the Ongoing Trade Dispute Stalemate between Boeing and Airbus has Undermined GATT and May Continue to Usher in an Era of International Agreement Obsolescence under the World Trade Organization”, 13 *Tulsa J. Comp. & Int'l L.* 177 (2005): 198, Available at: <http://digitalcommons.law.utulsa.edu/tjil/vol13/iss1/6> , accessed on April 24, 2020; Nils Meier-Kaienburg, *Op. Cit*, p. 202.

⁶⁵ Marc C. Mathis, *Op. Cit*, p. 197.

“traffic light” approach.⁶⁶ The three categories in the SCM Agreement are prohibited subsidies as the “red light”, actionable subsidies as the “yellow light” (permitted, but potentially subject to action) and non-actionable subsidies as the “green light” (permitted, and shielded from action).⁶⁷ The “traffic light” approach considered as the most important innovation of the Uruguay Round negotiations which stated by Jurgen Stehn on his article:

“The most important innovation of the Uruguay Round negotiations is the introduction of a "traffic lights" approach that divides subsidies into three categories: (1) prohibited; (2) actionable; (3) nonactionable. For the first time in the history of the GATT, this approach draws a direct link between the rules for the granting of subsidies and the regulations for the imposition of countervailing duties by providing that prohibited and actionable subsidies can be countervailed under certain conditions, whereas — as a general rule — no countermeasures can be taken against nonactionable subsidies.”⁶⁸

Until recently, the Agreement on Subsidies and Countervailing Measures still available, and it used in many subsidy problem and case, such as the case between the U.S and European Union in WTO case number DS353 *US — Large Civil Aircraft (2nd Complaint)*.

2. Definition of Subsidy in WTO

The clear definition of subsidy was still ambiguous, but after the SCM Agreement entry into force the clear definition of subsidy is announced and it became the new way for WTO to enforce the subsidy law with clearer path.⁶⁹ In the SCM Agreement the definition of subsidy is written in Article 1, and the definition of subsidy is:

⁶⁶ Jurgen Stehn, *Loc. Cit.*

⁶⁷ World Trade Report 2006, *Loc. Cit.*; Jeffrey D. Kienstra, *Loc. Cit.*

⁶⁸ Jurgen Stehn, *Op. Cit*, p. 6.

⁶⁹ Marc C. Mathis, *Op. Cit*, p. 199.

“1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:
 (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:
 (i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
 (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits)⁷⁰;
 (iii) a government provides goods or services other than general infrastructure, or purchases goods;
 (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; or
 (a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and
 (b) a benefit is thereby conferred.”⁷⁰

Thus, the measure of a state that could be said as subsidy must fill three elements:

- a) It is a financial contribution
- b) The contribution is by a government or any public body within the territory of a Member and,
- c) The contribution confers a benefit.⁷¹

The three elements must be filled to conclude that a subsidy is exist or not.⁷²

The financial contribution is broadly mean as “money or anything else of value provided to a manufacturer or exporter at a cost less than would have been charged

⁷⁰ Article 1, Agreement on Subsidies and Countervailing Measures.

⁷¹ Jeffrey D. Kienstra, *Loc. Cit*; Rajeev Ahuja, “Export Incentives In India Within WTO Framework”, Working Paper No. 72, *Indian Council For Research On International Economic Relations*, July, 2001, p. 5, available at: <http://icrier.org/pdf/agree-f.pdf> , accessed on April 26, 2020; Ozgur Caliskan, “An Analysis of the Airbus-Boeing Dispute From the Perspective of the WTO Process”, *Ege Academic Review*, Vol: 10, Number: 4, October 2010, p. 1133; Yujin Baskett, *Op. Cit*, p. 2.

⁷² *Ibid*, Ozgur Caliskan; *Ibid*, Yujin Baskett.

in a commercial transaction.”⁷³ Then, the financial contribution could also in the form of direct transfers or of income or price support, and the direct transfers through the form of grants, loans, and equity infusion or could also be in the potential sense when government provides for loan guarantees,⁷⁴ and the rest forms of financial contribution could be read in the Article 1 of the SCM Agreement above. The financial contribution only will not constitute a subsidy, but there must be benefit to the recipients of the subsidy.⁷⁵

As mentioned above, subsidy was divided into three categories, prohibited subsidies, actionable subsidies and non-actionable subsidies. In the Article 31 of SCM Agreement mentioned that the non-actionable subsidies is not anymore available, since the availability was only for 5 five years after the SCM Agreement entry into force,⁷⁶ by now the non-actionable subsidies is no longer available, therefore, this paper will only explain the rest two categories of the subsidies, prohibited and actionable subsidies.

a. Prohibited Subsidies – Export Subsidies

In the Article 3 of the SCM Agreement defines prohibited subsidies – export subsidies as:

“3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

⁷³ Richard O. Cunningham, “Subsidies to Large Civil Aircraft Production: New WTO Subsidy Rules and Dispute Settlement Mechanism Alter Dynamics of U.S.-E.U. Dispute”, AIR & SPACE LAW, Fall 1999, p. 6, available at: <https://kluwerlawonline.com/AILA2020003> , accessed on April 26, 2020.

⁷⁴ Rajeev Ahuja, *Loc. Cit*; Agreement on Subsidies and Countervailing Measures, *Loc. Cit*.

⁷⁵ *Ibid*, Rajeev Ahuja; Nils Meier-Kaienburg, *Loc. Cit*.

⁷⁶ Article 31, Agreement on Subsidies and Countervailing Measures; Agreement on Subsidies and Countervailing Measures was entry into force on 31 December 1996.

subsidies contingent, in law or in fact⁷⁷, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I^{78,79}

Subsidies contingent on export performance are prohibited.⁸⁰ They are prohibited because they are specifically designed to distort international trade, and are therefore likely to hurt other countries' trade.⁸¹ Export subsidies is inherently favour domestic goods that are exported over competing foreign goods in the export markets. By their very nature, they give an advantage to the domestic goods by discriminating the goods made by foreign competitors, or simply the subsidy only assists the domestic producers against its competitors in foreign market.⁸²

There is one element mentioned in Article 3.1(a) of the SCM Agreement to declare that there is export subsidy exist, which is the subsidies shall contingent, in law or in fact. The contingent 'in fact' explanation is written under the footnote 4 of the SCM Agreement:

“This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.”⁸³

⁷⁷ This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision. (Footnote 4 of the SCM Agreement)

⁷⁸ Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement. (Footnote 5 of the SCM Agreement)

⁷⁹ Article 3, Agreement on Subsidies and Countervailing Measures.

⁸⁰ Rajeev Ahuja, *Op. Cit*, p. 8.

⁸¹ The WTO 'Fifth Edition', *Op. Cit*, p. 45.

⁸² Simon Lester, *Op. Cit*, p. 7.

⁸³ Footnote 4 of the Agreement on Subsidies and Countervailing Measures.

The explanation about contingent ‘in fact’ is still blurry, but in the WTO dispute settlement body panel have make the definition on contingent ‘in fact’, from the case of EU – Aircraft number DS316⁸⁴:

“The meaning of ‘contingent’ in Article 3.1(a) is ‘conditional’ or ‘dependent for its existence upon’. Thus, in order to qualify as a prohibited export subsidy, the grant of the subsidy must be *conditional* or *dependent upon* actual or anticipated export performance; or as we have put it above, a subsidy must be granted *because* of actual or anticipated export performance.”⁸⁵

Simply, cited from the WTO Appellate Body of Canada-Aircraft case DS222, The words of “*contingent*” is “*conditional*” and “*contingent... upon export performance*” signifies that the granting of the subsidy has to be somehow linked to actual or anticipated exports.⁸⁶ Then, the detail list about the sort kinds of export subsidies is listed under the Annex I of the SCM Agreement, which so called as the Illustrative List.⁸⁷

b. Actionable Subsidies

The SCM Agreement explains the actionables subsidies in the Article 5 as:

“No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:

⁸⁴ Simon Lester, *Op. Cit*, p. 19.

⁸⁵ Panel Report, European Communities and Certain Member States — Measures Affecting Trade in Large Civil Aircraft, WTO Doc WT/DS316/R (30 June 2010, adopted 1 June 2011) (‘*EC — Aircraft* Panel Report’).

⁸⁶ Pamela Finckenberg-Broman, “The many facets of export subsidies in WTO [A study of indirect export subsidies]”, Bachelor Thesis, Lunds Universitet, 2012, p. 29 available at: <https://www.researchgate.net/publication/316024591> , accessed on April 28, 2020; Canada-Aircraft, Appellate Body Report, World Trade Organization, paras.107 and 166 et seq.

⁸⁷ Stephen Creskoff and Peter Walkenhorst, “Implications of WTO Disciplines for Special Economic Zones in Developing Countries”, *The World Bank, Poverty Reduction and Economic Management Network, International Trade Department*, April 2009, Policy Research Working Paper 4892, pp. 14-15, available at: <https://openknowledge.worldbank.org/bitstream/handle/10986/4089/WPS4892.pdf?sequence=1> accessed on May 4, 2020; Rajeev Ahuja, *Op. Cit*, pp. 7-8.

- (a) injury to the domestic industry of another Member;
 - (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994;
 - (c) serious prejudice to the interests of another Member.
- This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture.”⁸⁸

As mentioned in the SCM Agreement and many articles, actionable subsidies are ‘specific’ subsidies that cause adverse effect to the other member states.⁸⁹ The elements that could cause the adverse effect and create actionable subsidies are:

- 1) Injury
- 2) Nullification or impairment, and
- 3) Serious prejudice.⁹⁰

The injury means that, there is injury occurs to the domestic manufacturer who produce the like product as the subsidized imports inside of the territory of the complainant.⁹¹ The second element is *nullification or impairment* of benefits means that the subsidy in the subsidizing member prevent trading partner to enjoy the benefit of multilateral market access or in another sentence, where improved access to market from a bound tariff reduction is undercut by subsidisation in that market.⁹²

⁸⁸ Article 5 of the Agreement on Subsidies and Countervailing Measures.

⁸⁹ *Ibid*, Agreement on Subsidies and Countervailing Measures; Alan O. Sykes, “The Questionable Case For Subsidies Regulation: A Comparative Perspective”, Fall 2010: Volume 2, Number 2, *Journal of Legal Analysis*, p. 482, Available at: <https://academic.oup.com/jla/article-abstract/2/2/473/910591> , accessed on April 25, 2020; Jurgen Stehn, *Loc. Cit*; Simon Lester, *Op. Cit*, p. 9.

⁹⁰ Rajeev Ahuja, *Op. Cit*, p. 9; *Ibid*, Simon Lester; Jurgen Stehn, *Loc. Cit*; Sykes, *Op. Cit*, p. 483.

⁹¹ Rajeev Ahuja, *Op. Cit*, p. 10; Creskoff and Walkenhorst, *Op. Cit*, p. 16.

⁹² WTO E-learning Copyright, “Detailed Presentation of Subsidies and Countervailing Measures in the WTO”, p. 15, available at: <https://www.uio.no/studier/emner/jus/jus/JUS5850/h17/tekster/overview-subsidies.pdf> , accessed

Serious Prejudice is the final element that cause adverse effect. Adverse effect arises where a subsidy leads to (a) displacement or impedance of the complaining Member's exports, either in the market of the subsidising Member or in a third country market (b) significant price undercutting or price suppression or (c) an increase in the subsidising Member's world market share in a subsidised primary product or commodity.⁹³

If there is specific actionables subsidies that cause adverse effect found, the injured member could proceed to challenge to the next level on the Dispute Settlement Mechanism, and cause the subsidizing Member to withdraw the subsidy or remove the adverse effects, or there could also choose the option on countervailing action.⁹⁴

3. Specificity

In the SCM Agreement also stipulates about the specificity of the subsidy:

"2.1 In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as "certain enterprises") within the jurisdiction of the granting authority, the following principles shall apply:

(a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific. ..."⁹⁵

on May 4, 2020. Here in after as 'WTO E-learning'; *Ibid*, Creskoff and Walkenhorst; *Ibid*, Rajeev Ahuja.

⁹³ Article 6(6.3), Agreement on Subsidies and Countervailing Measures; *Ibid*, Rajeev Ahuja; *Ibid*, WTO E-learning.

⁹⁴ *Ibid*, Rajeev Ahuja; *Ibid*, WTO E-learning; Konrad von Moltke, "Negotiating Subsidy Reduction in the World Trade Organization", *Published by the International Institute for Sustainable Development*, Canada, 2003, p. 10.

⁹⁵ Article 2, Agreement on Subsidies and Countervailing Measures.

As indicated above, the SCM Agreement only aims at disciplining the use of subsidies that are “specific”,⁹⁶ it will never subject to the SCM Agreement unless it has been specifically provided to an enterprise or industry or group of enterprises or industries.⁹⁷ Therefore, only the specific subsidy could be subject to the SCM Agreement disciplines, here are 4 categories of specificity:

- a) Enterprise-specificity: A government targets a particular company or companies for subsidization;
- b) Industry-specificity: A government targets a particular sector or sectors for subsidization.
- c) Regional specificity: A government targets producers in specified parts of its territory for subsidization.
- d) Prohibited subsidies: A government targets export goods or goods using domestic inputs for subsidization.⁹⁸

Thus, after the subsidy declared as specific, then the Agreement on Subsidies and Countervailing Measures will kick in and discipline the subsidy actors.⁹⁹ Even the element of specificity is important on disciplining subsidy, there is one special element in the clause of specificity, which is for the prohibited subsidies, because the subsidies listed as the prohibited subsidies or the Article 3 of SCM Agreement

⁹⁶ World Trade Report 2006, *Op. Cit.*, p. 198.

⁹⁷ WTO Official Website, “Subsidies And Countervailing Measures: Overview ‘Agreement on Subsidies and Countervailing Measures (“SCM Agreement”)””, available at: https://www.wto.org/english/tratop_e/scm_e/subs_e.htm, accessed on April 29, 2020. Here in after as ‘Overview SCM Agreement’; Simon Lester, *Loc. Cit.*

⁹⁸ *Ibid*, Overview SCM Agreement.

⁹⁹ Dominic Coppens, “How special is the Special and Differential Treatment under the SCM Agreement? A legal and normative analysis of WTO subsidy disciplines on developing countries”, *World Trade Review* 12: 1 (2013): 83. Available at: <https://core.ac.uk/download/pdf/85218145.pdf>, accessed on May 2, 2020; WTO E-learning, *Loc. Cit.*, pp. 10-11.

will be clearly declared as specific, because the design, structure, and architecture of the measures show the existence of the intent/effect of the subsidy.¹⁰⁰ Therefore, for the case of prohibited subsidies there is no need for examining its specificity.

4. Countervailing Measures

Countervailing measures is the form of trade remedies that applied for the subsidies matter, and it is stipulate under the Article 10 of the SCM Agreement as:

“Application of Article VI of GATT 1994

Members shall take all necessary steps to ensure that the imposition of a countervailing duty on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement. Countervailing duties may only be imposed pursuant to investigations initiated and conducted in accordance with the provisions of this Agreement and the Agreement on Agriculture.”¹⁰¹

Countervailing measure means action taken by the importing country, usually in the form of increased duties to offset subsidies given to producers or exporters in the exporting country.¹⁰² A Member may not be imposed with countervailing measure unless it determines that there are (1) subsidized imports, (2) injury to a domestic industry, and (3) a causal link between the subsidized imports and the injury.¹⁰³ As previously noted, the existence of a specific subsidy must be determined in accordance with the criteria written in the Part I of the Agreement.

¹⁰⁰ Article 2 (2.3) of Agreement on Subsidies and Countervailing Measures; Simon Lester, *Op. Cit.*, p. 9; Pamela Finckenberg-Broman, *Op. Cit.*, pp. 20, 28.

¹⁰¹ Article 10 of Agreement on Subsidies and Countervailing Measures.

¹⁰² Glossary, WTO Official Website, available at: https://www.wto.org/english/thewto_e/glossary_e/glossary_e.htm , accessed on May 5, 2020. [Glossary WTO]

¹⁰³ Creskoff and Walkenhorst, *Loc. Cit.*; Nandang Sutrisno, *Op. Cit.*, p. 236.

However, the criteria regarding injury and causation are found in Part V. One significant development of the SCM Agreement is in this area there is explicit authorization of cumulation of the effects of subsidized imports from more than one Member if the specified criteria are fulfilled.¹⁰⁴ In addition, Part V contains rules regarding the determination of the existence and amount of a benefit.¹⁰⁵

Part V of the SCM Agreement contains detailed rules regarding the initiation and conduct of countervailing investigations, from the imposition of preliminary and final measures, the use of undertakings, and the duration of measures. A key objective of these rules is to ensure that investigations are conducted in a transparent manner, that all interested parties have a full opportunity to defend their interests, and that investigating authorities adequately explain the bases for their determinations.¹⁰⁶

5. The Subsidies Committee and Subsidies Notifications

WTO established the Committee on Subsidies and Countervailing Measures, the Committee consisted of representative of every Members. The Committee had meet not less than twice a year,¹⁰⁷ and it gives opportunity to the Members to consult about the Subsidies Agreement and its objectives.¹⁰⁸ The Committee does not conduct the task by themselves, but they may set up subsidiary bodies as

¹⁰⁴ *Ibid*, Creskoff and Walkenhorst; Overview SCM Agreement, *Loc. Cit.*

¹⁰⁵ *Ibid*, Overview SCM Agreement.

¹⁰⁶ *Ibid*.

¹⁰⁷ Article 24(1) of Agreement on Subsidies and Countervailing Measures.

¹⁰⁸ International Trade Administration, "Trade Guide: WTO Subsidies Agreement", Official Website of United States Department on Commerce, available at: <https://www.trade.gov/trade-guide-wto-subsidies> , accessed on April 23,2020.

appropriate,¹⁰⁹ and called as the Permanent Group of Expert, it consists with five independent person which are highly qualified in the fields of subsidies and trade relations.¹¹⁰ The Committee is the body under the WTO who will receives the notifications of subsidy from the Members, notification itself defined in WTO as ‘a transparency obligation requiring member governments to report trade measures to the relevant WTO body if the measures might have an effect on other Members’¹¹¹

The Committee will be responsible on receiving the subsidy notifications of every Members, the notification requirements of the SCM Agreement can be divided into regular notification requirements, which apply in principle to all Members, and special notification requirements, which apply to Members invoking particular provisions.¹¹² The regular subsidy notification itself obliged under the article 25 of the SCM Agreement to be submitted not later than 30 June of each year:

“25.1 Members agree that, without prejudice to the provisions of paragraph 1 of Article XVI of GATT 1994, their notifications of subsidies shall be submitted not later than 30 June of each year and shall conform to the provisions of paragraphs 2 through 6.

25.2 Members shall notify any subsidy as defined in paragraph 1 of Article 1, which is specific within the meaning of Article 2, granted or maintained within their territories.

...”¹¹³

¹⁰⁹ Article 24(2) of Agreement on Subsidies and Countervailing Measures.

¹¹⁰ Article 24(3) of Agreement on Subsidies and Countervailing Measures.

¹¹¹ Glossary WTO, *Loc. Cit.*

¹¹² Technical Cooperation Handbook On Notification Requirements, “Part: Subsidies And Countervailing Measures”, World Trade Organization Official Handbook, 30 Agustus 2019, p. 2. ‘WTO Handbook on Notifications’

¹¹³ Article 25 of Agreement on Subsidies and Countervailing Measures.

From the article above, every Member shall give notifications on any subsidy that exist within their territories, and the notification will be given to the Committee on Subsidies and Countervailing Measures ‘CSCM’.¹¹⁴ Then, a multilateral subsidy supervision should provide that all plans to grant new or to change the existing subsidies are to be notified to and approved by the WTO CSCM.¹¹⁵ As for notifications require WTO Members to provide information about their use of subsidies, such as the Members require to submit a notification of all specific subsidies at regular intervals. In addition, Members are required to notify all other subsidies “which operate directly or indirectly to increase exports of any product from, or to reduce imports of any product into, the territory of the Member granting or maintaining the subsidies” pursuant to Article XVI of GATT 1994,¹¹⁶ or as mentioned in the SCM Agreement:

“25.3 The content of notifications should be sufficiently specific to enable other Members to evaluate the trade effects and to understand the operation of notified subsidy programmes. In this connection, and without prejudice to the contents and form of the questionnaire on subsidies, Members shall ensure that their notifications contain the following information:

- (i) form of a subsidy (i.e. grant, loan, tax concession, etc.);
- (ii) subsidy per unit or, in cases where this is not possible, the total amount or the annual amount budgeted for that subsidy (indicating, if possible, the average subsidy per unit in the previous year);
- (iii) policy objective and/or purpose of a subsidy;
- (iv) duration of a subsidy and/or any other time-limits attached to it;
- (v) statistical data permitting an assessment of the trade effects of a subsidy.”¹¹⁷

Other than the notifications on subsidy, the SCM Agreement also have the notification on countervailing measures (Article 25.11) and competent authorities

¹¹⁴ WTO Handbook on Notifications, *Op. Cit.*, p. 3.

¹¹⁵ Jurgen Stehn, *Op. Cit.*, pp. 12-13.

¹¹⁶ World Trade Report 2006, *Op. Cit.*, p. 111.

¹¹⁷ Article 25(25.3) of Agreement on Subsidies and Countervailing Measures.

that conduct countervailing duty investigations (Article 25.12). Then, in addition, Article 32.6 in Part XI of the SCM Agreement ("Final Provisions") requires notification of laws and regulations relevant to the SCM Agreement.¹¹⁸

The explanation on notification above tells that the SCM Agreement is quite detail on its regulation toward subsidy, since the notifications consist not only relating on subsidy, and the notification also shall contain specific requirement as mentioned under the SCM Agreement. In principle, WTO notifications represent a rather unique source of information on the use of subsidies,¹¹⁹ and by the notifications also, the Members will able to evaluate the effects of trade and understand how the operations of the subsidy.

C. Islamic Perspective on International Trade

Trade is a human activity on processing goods and services resources to be distributed to meet the needs and desires of the community which aim to confers benefit.¹²⁰ Trading is divided into two kinds, domestic trade known as trade in domestic area or trade activity that conducted within a territory of a state and foreign trade known as international trade, conduct trade activity between nations.¹²¹ International trade activities which involving two or more countries turns out to cause various problems. This is something that cannot be avoided, because every country have legal, cultural and ethical concepts that underlie its

¹¹⁸ WTO Handbook on Notifications, *Op. Cit.*, p. 2.

¹¹⁹ World Trade Report 2006, *Loc. Cit.*

¹²⁰ Emi R. Emawan, *Business Ethics (Etika Bisnis)*, (Bandung: Penerbit Alfabeta, 2007), p. 11.

¹²¹ Hakim Muda Harahap, "Epistemologi Etika Perdagangan Internasional Dalam Konsep Alquran", *AL QUDS : Jurnal Studi Alquran dan Hadis* vol. 3, no 2 (2019): 222 available at: <http://journal.staincurup.ac.id/index.php/alquds>, accessed on May 9, 2020.

trade rules,¹²² and each country has different legal system on conducting trade, by this variousity, it could lead to cause problems in international trade.¹²³ From the past experience on having problems with international trade, therefore, countries in the world tried to create an institution of international trade organizations to unite differences in the principle of trade in a broad regulatory framework that can apply to all countries involved in world trade, and named as the World Trade Organization,¹²⁴ not only WTO, there were also another international institution created, called as IMF.¹²⁵

International trade gradually create some cases, and it could be because there is violation on the trade ethic, whereas, the application of international trade ethics can guarantee the sustainability of fair and upholding the just international trade and civilized human values.¹²⁶ Ethics on trade is important, and it is also written under Al-Qur'an, where for islam Al-Qur'an is the guide for all human being,¹²⁷ the guidance of all *dunya* matters including trade. Islamic expert like Fazlurrahman, and non-Muslims like W. Montgomery acknowledged that one of the greatest ideas of the Quran is offers the concept of trade ethics.¹²⁸ Then beside the ideas of Quran, Rasulullah SAW also gave new values on conducting trade in the era of *jahiliyah*, there were moral ethical values of trade, where trade must

¹²² Howard S. Ellis dan Llyod S, Metzler, "Reading in The Theori Of International Trade", London: George Allen and Unwin, (1950): pp. 204-212.

¹²³ Ana Mercedes Lopez Rodriquez, "Lex Mercatoria", 2 *Retzvidenskabeligt Tidskrit, Argang: Juridiks Insitut Aarhus Universitet*, (2002): p. 47.

¹²⁴ Sutiarnoto, *Hukum Penyelesaian Sengketa Perdagangan Internasional*, (Medan: USU Press, 2016), 1.

¹²⁵ T. May Rudy, SH, *Hubungan Internasional Kontemporer dan Masalah-masalah Global: Isu, Konsep, Teori dan paradigam*, (Bandung: PT. Refika Aditama, 2003), 32.

¹²⁶ Hakim Muda Harahap, *Op. Cit*, p. 223.

¹²⁷ *Ibid.*

¹²⁸ *Ibid.*

always be based on mutual trust and giving profits to both parties when they conduct transactions, there is trust arises, for example in practice, the trader able to show his honesty on conducting commercial practice.¹²⁹

The concept of international trade is basically same with the concept of trade in general. In Al-Qur'an also did not directly mention about international trade, but the concept of trade is explained through what so called as *at-tijara, al-bai'* and *isy tara*, which categorized as *isim nakirah* in the matter of trade.¹³⁰ *Isim nakirah* is isim that mentioning something unspecified.¹³¹ In this matter is about trade, that in Al-Quran trade is not specified to be domestic trade or international trade. As explained by Harahap in his article:

“The term-tijarah is like a verse in the surah an-nisa 'verse 29:

إِلَّا أَنْ تَكُونَ تِجَارَةً

The underlined contains general meaning because lafaz isim nakirah who can accept alif and lam. Something lafaz which can accept alif and lam is called nakirah isim. Isim nakirah used to refer to sentences in general, not to mention directly about domestic trade and international trade. However explicitly, international trade has existed since ancient times.”¹³²

Trading in the Qur'an clearly stated that trade or commerce is the path ordered by Allah to prevent people from doing the wrong act on conducting trade or sell and purchase between people. As mentioned under An-Nisa verse 29:

¹²⁹ Windari, “Perdagangan Dalam Islam”, *Al-Masharif, Padang*, Volume 3, No. 2, July-December 2015, p. 20, available at: <http://jurnal.iain-padangsidimpuan.ac.id/index.php/Al-masharif/article/view/836/725> , accessed on May 9, 2020.

¹³⁰ Hakim Muda Harahap, *Op. Cit.*, p. 224.

¹³¹ Hamka Ilyas, “Al-Nakirah Wa Al-Ma'rifah”, *UIN Alauddin, Makassar, Vol. 3 No. 2*, January-June 2015, p. 8, available at: <http://journal.uin-alauddin.ac.id/index.php/Shautul-Arabiyah/article/download/1253/1207> , accessed on May 10, 2020.

¹³² Hakim Muda Harahap, *Loc. Cit.*

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا أَمْوَالَكُم بَيْنَكُم بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً
عَنْ تَرَاضٍ مِنْكُمْ وَلَا تَقْتُلُوا أَنْفُسَكُمْ إِنَّ اللَّهَ كَانَ بِكُمْ رَحِيمًا

Meaning: “O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent. And do not kill yourselves [or one another]. Indeed, Allah is to you ever Merciful”

The verse explains the prohibition on kill ourselves and other people, because killing people means we are killing ourselves, an ummah is a unity, it's the same as eating your neighbor's property in a bad way, except by the way of trade that applies with mutual consent of both parties.¹³³

Then, there is also another verse in Qur'an that tells about trade, Al-Jumuah verse 10:

فَإِذَا قُضِيَتِ الصَّلَاةُ فَانْتَشِرُوا فِي الْأَرْضِ وَابْتَغُوا مِنْ فَضْلِ اللَّهِ وَاذْكُرُوا
اللَّهَ كَثِيرًا لَعَلَّكُمْ تُفْلِحُونَ

Meaning: “And when the prayer has been concluded, disperse within the land and seek from the bounty of Allah, and remember Allah often that you may succeed.”

Allah through surah al-Jumu'ah (62): 10 implies international trade by ordering his believers to search rizki and bounty from domestic area to abroad. This is

¹³³ Windari, *Op. Cit.*, p. 24.

confirmed in the interpretation of al-Qurthubi,¹³⁴ and it also applied in Surah Al-Mulk verse 15 and Fussilat verse 10.¹³⁵

Al-Mulk verse 15:

هُوَ الَّذِي جَعَلَ لَكُمُ الْأَرْضَ ذَلُولًا فَامْشُوا فِي مَنَاكِبِهَا وَكُلُوا مِنْ رِزْقِهِ
وَإِلَيْهِ النُّشُورُ

Meaning: “It is He who made the earth tame for you – so walk among its slopes and eat of His provision – and to Him is the resurrection.”

Fussilat verse 10:

وَجَعَلَ فِيهَا رَوَاسِيَ مِنْ فَوْقِهَا وَبَارَكَ فِيهَا وَقَدَّرَ فِيهَا أَقْوَاتَهَا فِي أَرْبَعَةِ أَيَّامٍ
سَوَاءً لِّلسَّائِلِينَ

Meaning: “And He placed on the earth firmly set mountains over its surface, and He blessed it and determined therein its [creatures’] sustenance in four days without distinction – for [the information] of those who ask.”

In interpreting of the verse above, Al Qurtubi narrates the interpretation of two great experts from the tabi'in, namely 'Ikrimah and Al Dahâk which says: "He determines to him the levels of food (the inhabitants) ", that Allah gives sustenance to its inhabitants with something that suitable for their lives which it will be not same with inhabitants of another area, Allah give every place with something that

¹³⁴ Hakim Muda Harahap, *Op. Cit*, p. 225.

¹³⁵ *Ibid*.

suitable for them, so with that, people can support each other through trade and travel from one country to another, on the matter of fulfilling their needs.¹³⁶

Likewise Imam Al Maraghi was a contemporary mufasir from Egypt says: (He determine the level of foods (its inhabitants)'), which Allah determines for the inhabitants of the land that their natural resources are suitable with their natural conditions, such as for the source of food, clothing and herbs. Simply, Allah gives every country different kind of natural resources, and many countries might exchanging their natural resources through trade. Traders among them circulate and transport what has been produced by one country to another and from one region to another region. This is in order to prosper the world and the system.¹³⁷

Trade is an act that allowed by Allah SWT, but on its application, trade shall follow the principle in *muamalah*, the principle mentioned as follow:

- 1) Basically every conduct on *muamalah* is *mubah*, except for the act that ordered by Al-Qur'an and Sunnah of The Prophet,
- 2) *Muamalah* is conducted voluntarily without any force from other party.
- 3) *Muamalah* is conducted by considering that it will give benefit and avoid *mudharat* in people's life.
- 4) *Muamalah* is conducted by adjusting with the values of fairness, and avoid the elements on taking opportunities in a narrow situation.¹³⁸

¹³⁶ Atep Hendang Waluya, "Perdagangan Internasional Dalam Islam", *Majalah Tabligh No. 4 / XIV*, Mei 2016, p. 55, available at: <https://www.researchgate.net/publication/334959466> , accessed on May 9, 2020.

¹³⁷ *Ibid.*

¹³⁸ Ahmad Azhar Basjir, *Asas Asas Hukum Muamalat Hukum Perdata Islam*, (Yogyakarta: UII Press, 2000), 16.

In Islam, the aim of international trade is to create the welfare and benefit of all humanity. As stated by Dr. Jaribah bin Ahmad Al Haritsi, he said that international economic relations can produce or provide enormous benefits for Muslims and avoid *mudharat* between Muslims.¹³⁹

There was prove that Islamic teaching was used as the basis of international trade, from the *Amwal Book* concerning on Economic created by Abu 'Ubaid, in his book he concluded that customs was always be enforced in the *jahiliyah* era. Then Allah canceled the customs system by sending Rasulullah and Islam. Then comes the obligation to pay zakat as much as a quarter of *'usyur* (2.5%). From Ziyad bin Hudair, he said, "I was appointed Umar to become a customs officer. Then he ordered me to take the customs from imported goods of *kafir harbi* traders as much as *'usyur* (10%), merchant imports from *dzimmah* counted for half of the *'usyur* (5%), and imported goods from Muslim traders a quarter of the *'usyur* (2.5%)"¹⁴⁰

From the prove above, it shows that Islam has already applying the international trade, and the matter of customs became one of the case in that era, and it was far before WTO appears, Islam already applying customs on trading. Then, at last, history also proves how trading became one of the media that made

¹³⁹ Achmad Lubabul Chadziq, "Perdagangan Internasional (Studi Komparasi Perdagangan Internasional Konvensional dan Islam)", *AKADEMIKA*, Vol.10, No. 2, December 2016, p. 162.

¹⁴⁰ Junaidi Safitri & Abdulmuhammad Fakhri, "Comparative Analysis of Abu 'Ubaid Al-Qasim and Adam Smith's Thought on International Trade", *Millah: Jurnal Studi Agama*, Vol. XVII, no. 1 (2017), p. 89, available at: <https://journal.uin.ac.id/Millah/article/download/10051/8049> , accessed on May 12, 2020.

Islam spread to various regions in the world. Through trade also, Islam can be accepted in various regions peacefully and still imprints until now.¹⁴¹

Prophet Muhammad was interest with trade because he always follows his uncle Abu Thalib when he was conducting trade around Makkah and other places. As Prophet Muhammad grew up, he enterprising himself to conduct business and trade with his own money or do a partnership with the other business actor, the partnership known as the system of *Mudhorabah* and *Musyarakah*, and remain popular until now.¹⁴² One of his business partner was Khadijah R.A, who also became Prophet Muhammad's wife. After the marriage, Prophet Muhammad increased his capacity on trading, he conducted international trade to Syam, Syiria, Yemen, etc.¹⁴³ Prophet Muhammad is a professional trader, he lifted up the value of honesty, and he got the title of '*Al-Amiin*' (the most trusted) in his young age. By that title, many business actor was interest to make trade partnership with him.¹⁴⁴

From the explanation above, it simply give the writer understand that trade was already conducted in the era of Prophet Muhammad, the trading was not only conducted domestically but it also internationally. The most basic value that the writer can learn are conducting trade with trust and justice.

¹⁴¹ Junaidi Safitri & Abdulmuhaimin Fakhri, *Op. Cit*, p. 87.

¹⁴² Muhammad Saifullah, "Etika Bisnis Islami Dalam Praktek Bisnis Rasulullah", Walisongo, Volume 19, Nomor 1, Mei 2011, p. 128, available at: http://eprints.walisongo.ac.id/1942/1/Saifullah-Etika_bisnis_Islami.pdf; Nihayatur Rohmah, "Perdagangan Ala Nabi Muhammad SAW Gambaran Tauladan Yang Hilang Di Perdagangan Global", E-journal, IAI Ngawi Jatim, p. 4, available at: <http://ejournal.kopertais4.or.id/mataraman/index.php/tahdzib/article/download/2371/2391>

¹⁴³ Nihayatur Rohmah, *Op. Cit*.

¹⁴⁴ Muhammad Saifullah, *Op. Cit*.

CHAPTER III

**ANALYSIS ON SUBSIDY CONTROL UNDER WTO AND THE
PROHIBITED SUBSIDIES FROM THE U.S GOVERNMENT FOR
BOEING LCA**

A. Background of The Case

On 27 June 2005, the European Communities requested consultations with the United States concerning prohibited and actionable subsidies provided to US producers of large civil aircraft. The European Communities claimed (a) that the United States acted inconsistently with certain provisions of Articles 5 and 6 of the SCM Agreement because the effect of the alleged subsidies was to cause adverse effects to its interests in the form of serious prejudice; (b) that the United States acted inconsistently with Article 3 of the SCM Agreement because the FSC/ETI and successor act subsidies constituted prohibited export subsidies; and (c) that the United States had violated agreed obligations concerning support to the large civil aircraft sector which set forth a bilateral 1992 Agreement between the United States and the European Communities on trade in large civil aircraft, thereby constituting serious prejudice to the European Communities' interests.

The case firstly arised in 2004, where the United States government, on behalf of Boeing, filed a complaint at the World Trade Organisation (WTO) against the European Union's conglomerate Airbus. Boeing claimed that the European Union had given illegal subsidies to Airbus which violated international trade policies

and distorted the commercial aviation's competitive landscape.¹ Then, in 24 hours European Union on behalf of Airbus filed complaint toward violation conducted by the United States.²

European Union claimed that there were numerous subsidies provided by the United States to Boeing, such as tax and non-tax incentives, property and sales tax breaks, payments and access to government facilities, equipment and employees, Waivers/transfers of intellectual property rights under NASA.³ All of those subsidies were provided by several institution in U.S. Boeing also received subsidies around 200 million every year from the export subsidies under the ETI (Extraterritorial Income Exclusion) Act, WTO even declares those subsidies are illegal.⁴ By that violation, European Communities filed the complaint, even though the panel of WTO Dispute Settlement Body did not grant all of the European Communities claim, but at least the prohibited subsidies are proven under the panel finding. EC's complaint named as DS353 US – Large Civil Aircraft (2nd Complaint) with United States as the respondent.

Thus, to know more about the case especially on the matter of subsidies, this paper analyzed and discussed (1) how WTO controls the subsidies under the Agreement of Subsidies and Countervailing Measures, and (2) why the subsidies were received by Boeing were categorized as prohibited subsidy.

¹ *EU – Large Civil Aircraft*, Request for Consultations by the United States, WT/DS316/1 (Oct. 12, 2004); Yujin Baskett, *Op. Cit.*, p. 1.

² *US – Large Civil Aircraft*, Request for Consultations by the European Communities, WT/DS317/1 (Oct. 12, 2004).

³ *US – Large Civil Aircraft (2nd Complaint)* in Official Website of WTO, *Loc. Cit.*

⁴ European Trade Commission, *US-Boeing*, *Loc. Cit.*

B. Subsidy Controls Under The WTO

Subsidy controls in WTO aims to avoid any potential on creating unfair competitions that could lead to trade distortions. Even though the subsidies are also a useful governmental instrument to accomplish their goal,⁵ control is still needed to avoid any kind of violation. On managing the subsidies of its Member, WTO had a special committee to control subsidies, it is called as Committee on Subsidies and Countervailing Measures, here in after refer as “The Committee”, which composed from the representative of each Member State.⁶ On the SCM Agreement, Members are obligate to submit a variety of notifications related to subsidy to The Committee.⁷ By submitting these notifications, The Committee could indirectly control the subsidy of Members who submit their notification, and the collaboration of both systems will make the subsidies from all Members are transparent for every Members. This part is focus on the notifications and the Committee explanation.

1. The Committee on Subsidies and Countervailing Measures

The Committee has responsibilities to allow the Members to consult about the Agreement, from the operation to the objectives,⁸ and the Committee also

⁵ Md. Rezaul Karim, “Transparency is the Most Important Governance Issue in the WTO Subsidy Control”, *University of Birmingham, Article in SSRN Electronic Journal*, January 2014, p. 10, available on: <https://www.researchgate.net/publication/314533078> , accessed on July 10, 2020.

⁶ Article 24(1) of Agreement on Subsidies and Countervailing Measures.

⁷ Subsidies And Countervailing Measures: Notifications ‘Notifications under the Agreement on Subsidies and Countervailing Measures’, World Trade Organization, Official Website of WTO, available on: https://www.wto.org/english/tratop_e/scm_e/notif_e.htm , accessed on July 8, 2020 ‘Notifications Under SCM Agreement’

⁸ Agreement on Subsidies and Countervailing Measures, *Loc. Cit.*

supervises the implementation of the Agreement.⁹ Under the SCM Agreement, the Committee does not conduct the task by themselves, but it may set up subsidiary bodies,¹⁰ called as the Permanent Group of Expert “PGE”, it consists of five independent people which are highly qualified in the fields of subsidies and trade relations.¹¹ The tasks assigned to the PGE by the Agreement are: to provide assistance to a Panel on request with regard to whether a measure is a prohibited subsidy, to provide a Member with confidential advisory opinions on the nature of any subsidy proposed to be introduced or currently maintained by that Member, and to provide the Committee with advisory opinions on the existence and nature of any subsidy.¹²

Basically, the Committee is the body under the WTO who has the responsibilities under the SCM Agreement, especially on the submission of notifications, consulting Members about the operation of the Agreement, assisting a panel, and gathering information related to the subsidies. The SCM Agreement did not stand alone behind the WTO, but it has institution to controlling most matter inside the Agreement.

2. Notifications related to subsidies

⁹ Subsidies and countervailing measures, World Trade Organization, Official Website of WTO, available on: https://www.wto.org/english/tratop_e/scm_e/scm_e.htm#dol , accessed on July 9, 2020.

¹⁰ Article 24(2) of Agreement on Subsidies and Countervailing Measures.

¹¹ Article 24(3) of Agreement on Subsidies and Countervailing Measures.

¹² Article 4(5) of Agreement on Subsidies and Countervailing Measures; World Trade Organization, Report (2018) of The Committee on Subsidies and Countervailing Measures, Documents, G/L/1272, 29 October 2018, p. 1, available on: https://www.wto.org/english/res_e/publications_e/ai17_e/subsidies_art24_oth.pdf , accessed on July 8, 2020. ‘SCM Committee Report 2018’

GATT Article XVI:1 generally requires all Members to notify on the extent, effect and circumstances of the subsidization.¹³ Also, the article 25.1 of the SCM Agreement requires that all Members submit a new and full notification of all specific subsidies every three years, with updating notifications due in the intervening years.¹⁴ The notifications content shall be specific, and the other Members are able to evaluate the trade effects and to understand the operation of notified subsidy programmes.¹⁵ There are general rules toward the subsidy notification under the article 25:

“1. The following subsidies are subject to notification under Article 25 of the Agreement on Subsidies and Countervailing Measures and under Article XVI of GATT 1994:

(a) all specific subsidies, as defined in Articles 1 and 2 of the Agreement on Subsidies and Countervailing Measures ("the SCM Agreement"), shall be notified pursuant to Article 25.2 of the SCM Agreement; and

(b) all other subsidies (i.e., in addition to those described in (a)), which operate directly or indirectly to increase exports of any product from, or to reduce imports of any product into, the territory of the Member granting or maintaining the subsidies, shall be notified pursuant to Article XVI:1 of GATT 1994.

2. It is understood that notifications made in accordance with the following questionnaire format will satisfy the notification requirements of both Article 25 of the SCM Agreement and Article XVI of GATT 1994.

3. Any Member considering that there are no measures in its territory requiring notification under the SCM Agreement and Article XVI of GATT 1994 shall so inform the Secretariat in writing. ...”¹⁶

Other than that, the general rules also include the content of notifications, in which the content does not prejudice either the GATT 1994 or the SCM

¹³ Article XVI.1, GATT 1994.

¹⁴ Article 25(1) of Agreement on Subsidies and Countervailing Measures; Notifications under SCM Agreement, *Loc. Cit.*

¹⁵ Article 25(3) of Agreement on Subsidies and Countervailing Measures.

¹⁶ World Trade Organization, “Questionnaire Format for Subsidy Notifications Under Article 25 of The Agreement on Subsidies and Countervailing Measures and Under Article XVI Of GATT 1994”, G/SCM/6/Rev.1, 11 November 2003, available on: <https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=Q:/G/SCM/6R1.pdf&Open=True>, accessed on July 10, 2020.

Agreement. Then, the notifications shall be submitted no later than 30 June of each year.¹⁷

General rules above stated that the notification requirements that shall be notify to the Committee. In addition, the Committee also had the information of what should be written under the notification:

- “1. Title of the subsidy programme, if relevant, or brief description or identification of the subsidy.
2. Period covered by the notification. The period to be covered by the notification should be the most recently completed calendar or fiscal year. In the latter case, the start and end dates of the fiscal year should be specified.
3. Policy objective and/or purpose of the subsidy.
4. Background and authority for the subsidy (including identification of the legislation under which it is granted).
5. Form of the subsidy (i.e., grant, loan, tax concession, etc.). ...”¹⁸

The notifications also requires to whom and how the subsidy is provided, duration of the subsidy, and statistical data assessment of the trade effects of the subsidy, from the production, consumption, import and export of the subsidized subsidies.¹⁹

Even though the SCM Agreement already requires Members to submit their subsidies notification in very specific rules, still, many Members did not respect the Agreement, for example in the notification report that collected by the Committee on 2018, many Members did not report their subsidies, it had been a problem ever since the SCM Agreement was entered into force:

Table 2. 2017 New and Full Subsidy Notifications²⁰

Member		Member		Member		Member	
Afghanistan	N	Czech Republic	X	India	X	Paraguay	N

¹⁷ *Ibid.*

¹⁸ *Ibid*; the information requested in points 1-9 must be provided in full: (a) for all subsidies in the case of full notifications (b) for subsidies notified for the first time in update notifications.

¹⁹ *Ibid.*

²⁰ SCM Committee Report 2018, *Op. Cit.*, p. 8.

Albania	None	Denmark	X	Indonesia	None	Peru	X
Angola	None	Estonia	X	Israel	X	Philippines	X
Antigua & Barbuda	X	Finland	X	Jamaica	None	Qatar	None
Argentina	X	France	X	Japan	X	Russian Federation	X
Armenia	None	Germany	X	Jordan	X	Rwanda	None
Australia	X	Greece	X	Kazakhstan	X	St. Kitts & Nevis	X
Bahrain, Kingdom of	N	Hungary	X	Kenya	None	St. Lucia	None
Bangladesh	None	Ireland	X	Korea, Rep. of	X	St. Vincent & Grenadines	None
Barbados	None	Italy	X	Kuwait, State of	None	Samoa	None
Belize	X	Latvia	X	Kyrgyz Republic	None	Saudi Arabia, Kingdom of	N
Benin	None	Lithuania	X	Lao, People's Democratic Rep. of	None	Senegal	None
Bolivia, Plurinational State of	None	Luxembourg	X	Lesotho	None	Seychelles	None
Botswana	N	Malta	X	Liberia	None	Sierra Leone	None
Brazil	X	Netherlands	X	Liechtenstein	X	Singapore	N
Brunei Darussalam	None	Poland	X	Macao, China	X	Solomon Islands	None
Burkina Faso	None	Portugal	X	Madagascar	N	South Africa	None
Burundi	N	Romania	X	Malawi	N	Sri Lanka	None
Cabo Verde	None	Slovak Republic	X	Malaysia	X	Suriname	None
Cambodia	None	Slovenia	X	Maldives	None	Switzerland	X
Cameroon	None	Spain	X	Mali	N	Chinese Taipei	X
Canada	X	Sweden	X	Mauritania	None	Tajikistan	None
Central African Rep.	None	United Kingdom	X	Mauritius	None	Tanzania	None
Chad	None	Ecuador	N	Mexico	None	Thailand	X

Chile	X	Egypt	None	Moldova, Rep. of	N	The FYR of Macedonia	X
China	X	El Salvador	X	Mongolia	None	Togo	N
Colombia	None	Eswatini	None	Montenegro	None	Tonga	None
Congo	None	Fiji	None	Morocco	None	Trinidad & Tobago	None
Costa Rica	X	Gabon	N	Mozambique	None	Tunisia	None
Côte d'Ivoire	None	The Gambia	None	Myanmar	None	Turkey	X
Cuba	N	Georgia	None	Namibia	None	Uganda	None
Dem. Rep. of Congo	None	Ghana	None	Nepal	None	Ukraine	X
Djibouti	None	Grenada	X	New Zealand	X	United Arab Emirates	None
Dominica	X	Guatemala	X	Nicaragua	None	United States	X
Dominican Rep.	X	Guinea	None	Niger	None	Uruguay	None
EU	X	Guinea-Bissau	None	Nigeria	None	Vanuatu	None
Austria	X	Guyana	None	Norway	X	Venezuela, Bolivarian Republic of	None
Belgium	X	Haiti	None	Oman	N	Viet Nam	None
Bulgaria	X	Honduras	X	Pakistan	None	Yemen	None
Croatia	X	Hong Kong, China	X	Panama	None	Zambia	N
Cyprus	X	Iceland	X	Papua New Guinea	N	Zimbabwe	None

"N" - the Member has indicated that it maintains no notifiable subsidies.

"X" - the Member has notified subsidies.

"None" - no notification has been submitted.

The SCM Agreement already create a very specific rule related to notification of subsidy and the body who responsible in it, but the data above indicates that there are still many Members did not respect the SCM Agreement. By not heeding the rule, the other Members will not be able to notice the subsidy report of other

Members, and to evaluate it. It also could prevent WTO to conduct maximum work on controlling the subsidy, and creating a transparency subsidization.

C. Boeing Received Prohibited Subsidies from The U.S Government

Boeing in fact received many form of subsidies from the U.S government as explained below:

Table 3. Amount of subsidies to Boeing's LCA division over the period 1989-2006²¹

Government(s) or Government Agency	Measures found to constitute specific subsidies within the meaning of Articles 1 and 2	Amount of the subsidy to Boeing's LCA division over the period 1989-2006
NASA	<ul style="list-style-type: none"> - payments made to Boeing pursuant to procurement contracts entered into under the eight aeronautics R&D programmes at issue - access to government facilities, equipment, and employees provided to Boeing pursuant to procurement contracts and Space Act Agreements entered into under the eight aeronautics R&D programmes at issue 	\$2.6 billion
USDOD	<ul style="list-style-type: none"> - payments made to Boeing pursuant to assistance instruments entered into under the RDT&E programmes at issue - access to government facilities provided to Boeing pursuant to assistance instruments entered into under the RDT&E 	unclear

²¹ US — *Large Civil Aircraft (2nd Complaint)*, Panel Report, World Trade Organization, WT/DS353 /R, p. 584. 'US — *Large Civil Aircraft (2nd Complaint)* Panel Report'

	programmes at issue	
FSC/ETI	- the tax exemptions and tax exclusions provided to Boeing under FSC/ETI legislation, including the transition and grandfather provisions of the ETI Act and the AJCA	\$2.2 billion
State of Washington and Municipalities therein	<ul style="list-style-type: none"> - Business and Occupation ("B&O") tax reduction provided for in Washington House Bill 2294 ("HB 2294") - B&O tax credits for preproduction development, computer software and hardware and property taxes provided for in HB 2294 - sales and use tax exemptions for computer hardware, peripherals and software provided for in HB 2294 - City of Everett B&O tax reduction - workforce development programme and employment resource center 	\$77.7 million
State of Kansas and Municipalities therein	- property and sales tax abatements provided to Boeing pursuant to Industrial Revenue Bonds ("IRBs") issued by the State of Kansas and municipalities	\$476 million
State of Illinois and	- reimbursement of a portion of Boeing's relocation expenses	\$11 million

Municipalities therein	<p>provided for in the <i>Corporate Headquarters Relocation Act</i> ("CHRA")</p> <ul style="list-style-type: none"> - 15-year Economic Development for a Growing Economy ("EDGE") tax credits provided for in the CHRA - abatement or refund of a portion of Boeing's property taxes provided for in the CHRA - payment to retire the lease of the previous tenant of Boeing's new headquarters building 	
Total		at least \$5.3 billion

The complaint that was filed by European Union to WTO DSB alleged that the U.S Government gave aids or subsidies to Boeing, where some positions of the subsidies are categorized as prohibited subsidies under the SCM Agreement. The subsidies defined as prohibited subsidies because the “subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I” as mentioned under the article 3 of the SCM Agreement. In the *US – Large Civil Aircraft (2nd Complaint)* case, the Panel Report reports that the prohibited subsidies that were received by Boeing named as “FSC/ETI and successor act subsidies”.²² This part analyzed how the Tax Exemption from the U.S legislations through the FSC/ETI and successor act could be categorized as prohibited subsidies.

²² *US – Large Civil Aircraft (2nd Complaint)* Panel Report, *Op. Cit.*, p. 585.

1. Tax Exemption in the FSC/ETI and successor act subsidies

From the Table 3 above, the panel report had simplified the forms of subsidies received by Boeing, but, also under the panel report, there is only one subsidy that include as prohibited subsidies, which is the FSC/ETI. The other rest of the subsidies included as actionable subsidies. Therefore, this research paper only discuss related to the prohibited subsidies and specifically the FSC/ETI.

The Appellate Report stipulates that the European Communities challenged the tax exemption enjoyed by Boeing in relation to certain income under the FSC “*Foreign Sales Corporation*” legislation and under its successor legislation, namely: (1) *U.S. Internal Revenue Code relating to foreign sales corporations*, (2) The *FSC Repeal and Extraterritorial Income Exclusion Act of 2000* (the “ETI Act”), (3) the *American Jobs Creation Act of 2004* (the “AJCA”); and (4) the *Tax Increase Prevention and Reconciliation Act of 2005* (the “TIPRA”).^{23, 24} The European Communities filed the complaint about the FSC/ETI and successor act subsidies above, and claimed that the subsidies had violated article 3(1) and 3(2) of the SCM Agreement.²⁵

In the panel report, the European Communities requests to the Panel to make finding that the FSC/ETI and successor act subsidies fulfill the elements of prohibited subsidies, which are contingent upon export performance within the

²³ Appellate Body Report of *US — Large Civil Aircraft (2nd Complaint)*, World Trade Organization, WT/DS353/ABR, p. 185 ‘Appellate Body Report of *US — Large Civil Aircraft (2nd Complaint)*’; Panel Report of *US — Large Civil Aircraft (2nd Complaint)*, *Op. Cit.*, p. 570.

²⁴ 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, Pub. L. No. 106-519; and
c. American Jobs Creation Act of 2004, Pub. L. No. 108-357.

²⁵ *US — Large Civil Aircraft (2nd Complaint)* Panel Report, *Loc. Cit.*

meaning of article 3.1(a) of the SCM Agreement, and also request to the Panel to recommend the U.S to withdraw its prohibited subsidies without delay, as it is required under the article 4.7 of the SCM Agreement.²⁶

European Communities in their written submission presented that the FSC/ETI and successor act subsidies were complied with the export performance,²⁷ and U.S did not contest that these subsidies constituted export subsidies that do not complied with article 3 of the SCM Agreement.²⁸ Moreover, from 1989 through 2006, Boeing LCA had received \$2.199 billion of tax breaks from the FSC/ETI act. Below are explanation about the U.S legislation that had been used to create the prohibited subsidies:

a. U.S. Internal Revenue Code relating to foreign sales corporations

A FSC is a corporation created, organised, and maintained in a qualified foreign country, the corporation is under the US possession, but located outside the customs territory of the United States, and ruled under the specific requirements of Sections 921-927²⁹ of the US Internal Revenue Code.³⁰ FSC obtained a US tax exemption from a portion of its earnings (foreign trade income), means that the

²⁶ *US — Large Civil Aircraft (2nd Complaint)* Panel Report, *Op. Cit.*, p. 588.

²⁷ *US — Large Civil Aircraft (2nd Complaint)* Panel Report, *Op. Cit.*, p. 585.

²⁸ *US — Large Civil Aircraft (2nd Complaint)* Panel Report, *Op. Cit.*, p. 587.

²⁹ “*Exhibit EC-623. A FSC had to meet certain requirements of foreign presence. For example, a FSC had to maintain an office outside the customs territory of the United States, which office had to be equipped to transact the FSC's business. Also, in order for a FSC, other than a small FSC, to be treated as having foreign trading gross receipts for the taxable year, the management of the corporation during the taxable year had to take place outside the United States, and the corporation could have foreign trading gross receipts from any transaction only if economic processes with respect to the transaction took place outside the United State*” *US — Large Civil Aircraft (2nd Complaint)* Panel Report, p. 570.

³⁰ *US — Large Civil Aircraft (2nd Complaint)* Appellate Body Report, *Op. Cit.*, p. 186; Panel Report of DS108 ‘US-FSC’, World Trade Organization, WT/DS108/R, 8 October 1999, pp. 1-2, ‘Panel Report of US-FSC’.

gross income of FSC is attributable to “foreign trading gross receipts”.³¹ The ‘foreign trade income’ called as the “foreign source income was not effectively connected to a trade or business in the United States”, and was therefore the foreign trade income did not tax in the United States.

The FSC measure also allowed the US parents companies to delay on paying taxes on certain “foreign trade income” where it was normally shall be an immediate taxation, FSC measure also allowed the companies to avoid paying taxes on the dividends that received from their FSCs related to "foreign trade income".³² Moreover, the FSC measure was found by the Panel and Appellate Body in *US-FSC* to be inconsistent with United States’ obligation under the SCM Agreement article 3.1(a) and 3.2.³³

b. FSC Repeal and Extraterritorial Income Exclusion Act of 2000

Extraterritorial Income Exclusion “ETI” Act was enacted on 15 November 2000, the enactment occurred as U.S action to respect the finding in the FSCs provision from the Panel and Appellate Body of *US-FSC* case.^{34,35} The ETI Act (i) repealed the provisions in the U.S. Internal Revenue Code relating to taxation of

³¹ *Ibid*, Panel Report of *US-FSC*; Foreign trading gross receipts means the gross receipts of any FSC which are generated by qualifying transactions, which generally involve the sale or lease of “export property”. Export property is: (1) property held for sale or lease; (2) manufactured, produced, grown, or extracted in the United States; (3) by a person other than a FSC; (4) sold, leased, or rented for use, consumption, or disposition outside the United States, and; (5) with no more than 50 per cent of its fair market value attributable to imports.

³² *US — Large Civil Aircraft (2nd Complaint)* Appellate Body Report, *Loc. Cit.*

³³ *Ibid.*

³⁴ *US — Large Civil Aircraft (2nd Complaint)* Panel Report, *Op. Cit.*, p. 571.

³⁵ In the Panel Report of *US-FSC*, the Panel recommend United States to withdraw it FSCs subsidies without delay, and specifies that the withdraw is no more than 1 October 2000, considering on the Article 4.7 of the SCM Agreement, that Member shall withdraw a prohibited subsidy "without delay" and "in this regard" a panel must specify a time-period within which the measure must be withdrawn. (Panel Report of *US-FSC*, p. 294)

FSCs, subject to certain transition and grandfather provisions and (ii) introduced an exclusion from income taxation of "extraterritorial income".³⁶

The violations in this act were, first, the ETI Act amendments stipulate "shall apply to transactions after September 30, 2000".³⁷ While in the *US-FSC*, United States had withdrawn its FSCs subsidies on 1 October 2000 in order to respect the findings of the Panel. Thus, no new FSCs could be created after that date,³⁸ but the ETI Act remains created the FSCs. Second, the ETI Act allowed for the exclusion from taxation of certain income of a U.S. "taxpayer",³⁹ the income⁴⁰ was only earned from the transactions involving qualifying foreign trade property.⁴¹ The ETI Act defined "extraterritorial income" as the gross income of a taxpayer attributable to "foreign trading gross receipts", i.e. gross receipts generated by certain qualifying transactions involving the sale or lease of "qualifying foreign trade property" not for use in the United States.⁴² Thus, the compliance panel in *US – FSC (Article 21.5 – EC)* found that the ETI Act was inconsistent with the United States' WTO obligations under the SCM Agreement,⁴³ because the ETI Act had purposed to make untaxed transaction by making the property not for use in the territory of U.S.

c. American Jobs Creation Act of 2004 "AJCA"

³⁶ *US – Large Civil Aircraft (2nd Complaint)* Panel Report, *Loc. Cit.*

³⁷ The detail transaction is written under the Section 5(c) (1) of the ETI Act, where that provision provided that the amendments made by the Act did not apply to any transaction in the ordinary course of trade or business involving an FSC which occurred: (i) before 1 January 2002; or (ii) after 31 December 2001, pursuant to a binding contract between the FSC (or any related person) and any unrelated person that was in effect on 30 September 2000.

³⁸ *Ibid.*

³⁹ *US – Large Civil Aircraft (2nd Complaint)* Appellate Body Report, *Op. Cit.*, p. 187.

⁴⁰ The income is "extraterritorial income" that was "qualifying foreign trade income".

⁴¹ *US – Large Civil Aircraft (2nd Complaint)* Panel Report, *Loc. Cit.*

⁴² *Ibid.*; the qualifying foreign trade property defined at footnote 59 below.

⁴³ *US – Large Civil Aircraft (2nd Complaint)* Appellate Body Report, *Loc. Cit.*

The AJCA was enacted on 22 October 2004 as the action of U.S to replace ETI Act and in order to respect the finding of the panel and the Appellate Body on *US-FSC*.⁴⁴ There was certain provision (section 101) in the AJCA that repealed the provision in its grandfather legislation which is the IRC section 114 (Internal Revenue Code), the provision was related to the exclusion from income taxation of ETI.⁴⁵ The repeal was valid started from 31 December 2004.⁴⁶

In the AJCA, there was a transitional rule for year 2005 and 2006, the transitional rule in 2005 was explicitly allowed U.S taxpayers to claim 80 per cent of ETI tax benefit, for 2006 rule, the AJCA allowed U.S taxpayers to claim it for 60 per cent. Then, by that, the AJCA had actually grandfathered/continued the ETI scheme in order to conduct certain transaction.⁴⁷ The panel further noted about the indefinite grandfathering of the original FSC subsidies for certain transactions through the continued operation of section 5 of the ETI Act in the section 101 of the AJCA. Therefore, the panel concluded that the United States failed to fully implement the operative DSB recommendations and ordered U.S to withdraw the prohibited subsidies and to bring its measures into conformity with its obligations under the relevant covered agreements.⁴⁸

Moreover, after U.S failed to implement the DSB recommendations on their legislation, then the Tax Increase Prevention and Reconciliation Act of 2005

⁴⁴ Panel Report of *US-FSC* para 8.1(a) and Appellate Body Report of *US-FSC* para 177(a) conclude that the FSC scheme is inconsistency with article 3.1(a) of the SCM Agreement, since the FSC was granting and maintaining the export subsidies which is prohibited under the provision.

⁴⁵ *US — Large Civil Aircraft (2nd Complaint)* Appellate Body Report, *Loc. Cit.*

⁴⁶ *US — Large Civil Aircraft (2nd Complaint)* Panel Report, *Op. Cit.*, p. 572.

⁴⁷ *US — Large Civil Aircraft (2nd Complaint)* Appellate Body Report, *Op. Cit.*, p. 188; *US — Large Civil Aircraft (2nd Complaint)* Panel Report, *Loc. Cit.*

⁴⁸ *Ibid*, *US — Large Civil Aircraft (2nd Complaint)* Appellate Body Report.

enacted in respect to the recommendations. This act repeals section 5(c) of ETI Act and section 101 of AJCA, where both of these section was aimed on continuing the FSC benefits.⁴⁹

2. Analysis on the tax exemption as the prohibited subsidies

Based on article 1 of the SCM Agreement, subsidy is financial contribution from the government or public body in the territory of Member, and the financial contribution confers a benefit. Meanwhile, prohibited subsidies defined in the Chapter II of this research paper as “Subsidies contingent on export performance are prohibited”.⁵⁰ In addition, in the case *Canada-Aircraft*, contingent on export performance means every subsidy that granted and had the link to actual or anticipated export.⁵¹ Moreover, the type of export performance is explained under the Illustrative List of Annex I of the SCM Agreement, below is the Illustrative List that have connection with this research paper case,

“(a) The provision by governments of direct subsidies to a firm or an industry contingent upon export performance.

(e) The full or partial exemption remission, or deferral specifically related to exports, of direct taxes or social welfare charges paid or payable by industrial or commercial enterprises.

(g) The exemption or remission, in respect of the production and distribution of exported products, of indirect taxes in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption.

(h) The exemption, remission or deferral of prior-stage cumulative indirect taxes on goods or services used in the production of exported products in excess of the exemption, remission or deferral of like prior-stage cumulative indirect taxes on goods or services used in the production of like products when sold for domestic consumption; provided, however, that prior-stage cumulative indirect taxes may be exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products when sold for domestic consumption, if the prior-stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product (making normal

⁴⁹ *Ibid*; *US — Large Civil Aircraft (2nd Complaint)* Panel Report, *Loc. Cit.*

⁵⁰ Rajeev Ahuja, *Op. Cit.*, p. 8.

⁵¹ Pamela Finckenberg-Broman, *Op. Cit.*, p. 29; *Canada-Aircraft*, Appellate Body Report, World Trade Organization, paras.107 & 166 et seq.

allowance for waste). This item shall be interpreted in accordance with the guidelines on consumption of inputs in the production process contained in Annex II.”⁵²

From the list above, it could indirectly be seen how the FSC/ETI and successor act subsidies linked with the category of prohibited subsidies. Thus, to conduct the analysis on prohibited subsidies, this paper used the definition of prohibited subsidies as every subsidy that granted has the link to actual or anticipated export or those that illustrated under Annex I, which in this case the anticipated export that included under the Annex I are in the form of tax exemption through the U.S legislation which consist of U.S Internal Revenue Code, ETI Act, and AJCA.

a. U.S. Internal Revenue Code relating to foreign sales corporations

The U.S Internal Revenue Code is included as subsidy,⁵³ because it is fulfilling the elements. First, there was financial contribution from the government, since the Internal Revenue Code was created by the U.S government, and in that Code also the tax exemptions ruled for the FSCs, which make the FSCs are not taxable

⁵² Annex I of the SCM Agreement; quoted from Annex I footnote 58, The term "direct taxes" shall mean taxes on wages, profits, interests, rents, royalties, and all other forms of income, and taxes on the ownership of real property; The term "import charges" shall mean tariffs, duties, and other fiscal charges not elsewhere enumerated in this note that are levied on imports; The term "indirect taxes" shall mean sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes and all taxes other than direct taxes and import charges; "Prior-stage" indirect taxes are those levied on goods or services used directly or indirectly in making the product; "Cumulative" indirect taxes are multi-staged taxes levied where there is no mechanism for subsequent crediting of the tax if the goods or services subject to tax at one stage of production are used in a succeeding stage of production; "Remission" of taxes includes the refund or rebate of taxes; "Remission or drawback" includes the full or partial exemption or deferral of import charges.

⁵³ *"The first is the tax exemptions comprised in the FSC scheme. These are essentially:*

- *The exclusion of the "foreign trade income" of FSCs from the controlled foreign corporations provisions of Subpart F of the IRC (Sections 951(e) and 954(d) and (e) IRC);*
 - *The exemption from US tax which would otherwise be due on the "exempt foreign trade income" of the FSC (Section 921(a) IRC).*
 - *The fact that the parent of the FSC is accorded a 100 per cent dividends received deduction (i.e. exemption from US tax) for the dividends received from the FSC from "earnings or profits attributable to foreign trade income" (Section 245(c) IRC in conjunction with Section 926(a))."*
- Panel Report US-FSC Para 4.270

under the U.S. Second element is the contribution confers benefit, there was calculation of the exempt foreign trade income of FSCs called as *special administrative pricing rules*. This special pricing rules increase the non-taxed profits of FSCs and reduce the taxed profits of the parent companies and consequently decrease the tax burden on exports effected under the FSC scheme.⁵⁴ Thus, the FSC scheme was actually the one who leads the revenue forgone.^{55,56} Then, the revenue is forgoing and equal to the sum of money which does not have to be paid in a form of taxes by FSCs and their parents\ companies, and this sum of money remains the property of the FSCs and their parents which benefits them.⁵⁷ Therefore, the U.S Government involved the foregoing of revenue which was otherwise due and conferred a benefit within the meaning of Article 1.1(b) of the SCM Agreement.⁵⁸

Moreover, related to the Illustrative List of the Annex 1 of the SCM Agreement, the exemption, remission or deferral of tax specifically related to export are considered as prohibited subsidies, and the U.S Internal Revenue Code had made special act for the FSCs to not to pay taxes and also the parent companies were allowed to delay or even avoid on paying taxes. By that, this part concluded that the U.S Internal Revenue Code is considered as prohibited subsidies.

⁵⁴ Panel Report of *US-FSC*, *Op. Cit.*, pp. 47-48.

⁵⁵ Panel Report of *US-FSC*, *Op. Cit.*, p. 49.

⁵⁶ “The revenue forgone is also referred to as tax expenditure or indirect subsidy to taxpayers.” Rajesh Kumar, “What Is Statement for Revenue Forgone”, e-Paper, March 2015, available at: <https://www.livemint.com/Money/3ymPkH5KGpq4q0Iic0sbNI/DYK--What-is-Statement-of-Revenue-Forgone.html> (accessed on July 7, 2020)

⁵⁷ Panel Report of *US-FSC*, *Op. Cit.*, p. 50.

⁵⁸ *US — Large Civil Aircraft (2nd Complaint)* Panel Report, *Op. Cit.*, p. 575.

b. FSC Repeal and Extraterritorial Income Exclusion Act of 2000

The panel in *US – FSC* (Article 21.5 – EC) made conclusion in respect to the ETI Act. There was financial contribution which confers benefit which can be derived from the explanation in *Canada – Aircraft*,

“This must be so, for there can be no "benefit" to the recipient unless the "financial contribution" makes the recipient "better off" than it would otherwise have been, absent that contribution”.⁵⁹

In the ETI Act, a taxpayer who involved in a qualifying transaction may exclude qualifying foreign trade income from its gross income and therefore no need to pay a certain amount of tax which it would otherwise have to pay to the United States government.⁶⁰ By not paying taxes, the Act gave “better off” contribution than it would otherwise have been for the taxpayer.⁶¹ In the ETI Act's exclusion from gross income of certain "extraterritorial income" support that there was a financial contribution in the form of a forgoing of government revenue within the meaning of Article 1.1(a)(1)(ii) and that this financial contribution conferred a benefit.⁶²

The “extraterritorial income” in the Act will be “excluded” from taxation if they are qualified and fulfil the requirements (qualifying foreign trade property⁶³). First, the use of the property is outside the United States and second, about the

⁵⁹ *Canada – Aircraft*, Appellate Body Report, *Op. Cit.*, para. 157.

⁶⁰ Panel Report of *US-FSC (Article 21.5 – EC)*, World Trade Organization, WT/DS108/RW, p. 29.

⁶¹ *Ibid.*

⁶² Panel Report of *US-FSC Article 21.5-EC, Op.Cit.*, pp. 28-29.

⁶³ *US — Large Civil Aircraft (2nd Complaint)* Panel Report, para. 7.1440, (“Qualifying foreign trade property”, which is generally property produced within or outside the United States that is sold for use outside the United States i.e. exports.)

foreign articles/labour limitation.⁶⁴ Furthermore, the Act also provides that the President may customize the property which are qualified as foreign trade property. The Act was so designated, and the “qualify foreign trade property” were deliberately customized by the government, because if the “qualify foreign trade property” were not designated, then the special tax treatment might not be available also,⁶⁵ and will not becoming prohibited subsidies, but the reality is otherwise.

“8.43 We therefore conclude that the exclusion from taxation by the United States of certain income on the basis of the Act's highly selective qualitative conditions and quantitative requirements relating to the definitions of "qualifying foreign trade property" and "foreign trading gross receipts" – which define what income may become "extraterritorial income", "foreign trade income" and "qualifying foreign trade income" -- results in the foregoing of revenue which is "otherwise due" and thus gives rise to a financial contribution with the meaning of Article 1.1(a)(1)(ii) of the *SCM Agreement*.”⁶⁶

The conclusion above presents the exclusion of tax conducted by the United States through the Act resulted foregoing of revenue, and prove that the “extraterritorial income” is a financial contribution from the government.

After the financial contribution from the government is proven, the Act can be categorized as subsidy by knowing whether there was benefit confers or not. Previously the taxpayers were capable to not paying taxes while it actually shall pay taxes in the United States. By not paying taxes, the taxpayers had already

⁶⁴ Panel Report of *US-FSC Article 21.5-EC, Op. Cit.*, p. 22.

⁶⁵ *Ibid.*

⁶⁶ Panel Report of *US-FSC Article 21.5-EC, Op. Cit.*, p. 28.

received benefits, since their sum of money still in their possession. Thus, the panel views that the tax treatment in the Act confers a benefit.⁶⁷

After the elements of subsidy is fulfilled, then, there must be also analysis whether the ETI Act is categorized as prohibited subsidy or not. There must be an element of “contingent upon export performances” proven to know if the Act is prohibited subsidy or not as within the meaning of the article 3.1(a) of the SCM Agreement.

“Since, in order for a transaction involving US-produced goods to qualify for the tax exclusion under the Act, the goods must not be "for use in the United States", it follows that these goods must be sent across the US border and moved outside US territory, generally, and in the usual case not involving questions of territorial waters, into another country. In our view, this means that, in respect of US-produced goods, the subsidy is conditioned upon export.”⁶⁸

The explanation from the panel above simply proved that the Act is subsidy conditioned upon export performance because the tax exclusion will be available if the property/good is “for use outside the United States”. The ETI Act is somehow continuing the FSC scheme from the Internal Revenue Code, because the location of the FSCs in ETI Act are also outside the customs territory of U.S. Therefore, the goods in the FSC are not taxable under the Internal Revenue Code and remain continue in the ETI Act which it inconsistent with Article 3.1(a) of the SCM Agreement.^{69,70}

c. American Jobs Creation Act of 2004 “AJCA”

⁶⁷ Panel Report of *US-FSC Article 21.5-EC, Op. Cit.*, p. 29.

⁶⁸ Panel Report of *US-FSC Article 21.5-EC, Op. Cit.*, p. 36.

⁶⁹ *Ibid.*

⁷⁰ The panel also stipulate, by proving the Act is contingent upon export performance, the panel do not consider that it is necessary to examine the clause included to the illustrative list of Annex 1 of the SCM Agreement.

In *US – FSC* (Article 21.5 – EC II), the panel found that the United States, by enacting Section 101 of the AJCA, maintained prohibited FSC and ETI subsidies through transition and grandfather clauses in section 101 of the AJCA and by that the United States continued to fail to implement fully the operative DSB recommendations and rulings to withdraw the prohibited subsidies.⁷¹ In this part, there will be no need to prove whether AJCA is fulfilling the elements of subsidy or not and also to prove whether it is prohibited subsidy or not, because, by proving that AJCA remains continuing the function of ETI Act, then it could answer all of the elements above.

The finding of panel and Appellate Body in the first 21.5 compliance proceedings, established that the ETI scheme violates article 3.1(a) and 3.2 of the SCM Agreement. Then, in the introduction of AJCA above, the ETI benefits remain available during 2005 and 2006 under the AJCA article 101. The United States confirm that there was no modifications of legislative language in the AJCA about the transition rules of the FSC scheme.⁷² By that, it is clear to say that there is indefinite grandfather legislation. Then, the final conclusion of the panel was:

“Accordingly, we find that, to the extent that the United States, by enacting Section 101 of the Jobs Act, maintains prohibited FSC and ETI subsidies through these transitional and grandfathering measures, it continues to fail to implement fully the operative DSB recommendations and rulings to withdraw the prohibited subsidies and to bring its measures into conformity with its obligations under the relevant covered agreements.”⁷³

⁷¹ *US – Large Civil Aircraft (2nd Complaint)* Panel Report, *Op. Cit.*, p. 589.

⁷² Panel Report of *US-FSC (Article 21.5 – EC II)*, World Trade Organization, WT/DS108/RW2, p. 23. ‘Panel Report of *US-FSC Article 21.5-EC II*’

⁷³ Panel Report of *US-FSC Article 21.5-EC II*, *Op. Cit.*, p. 24.

Therefore, the AJCA is proven as the prohibited subsidy, since the provisions inside of it are remain continuing the provision of the previous legislation where the provision aims to exempt the tax of FSC.



CHAPTER IV

CLOSING

A. CONCLUSIONS

1. Control of subsidy in WTO is conducted by the Committee on Subsidy and Countervailing Measures, the Committee will receive notifications made by Member States. The notification itself is obliged under the GATT Article XVI: 1 and Article 25.1 of the SCM Agreement. Through the notification, Committee will be able to manage and control the flow of subsidy of every Member State and keep the transparent trade among the Member. The Committee is not the one who are able to see the flow of subsidy, but every Member could see and evaluate another Member's subsidy. Therefore, the most important point to control the subsidy is by annually reporting every Member State's notification related to subsidy to the Committee of Subsidies and Countervailing Measures.
2. Under the Panel and Appellate Body report of *US — Large Civil Aircraft (2nd Complaint)*, prohibited subsidy found in the case is the FSC/ETI Acts (US Internal Revenue Code, Extraterritorial Income Exclusion Act (ETI), and American Jobs Creation Acts (AJCA)). This subsidy defined as prohibited subsidy because the aim of the acts/legislations that made by the Government of United States are similar to or fulfill the illustrative list of Annex 1 of the SCM Agreement and there is link to the actual export

performance (in accordance with article 3.1 (a) and illustrative list paragraph a), and there is tax exemption occur (in accordance with Illustrative list Annex I paragraph e, g, and h). First, U.S Internal Revenue Code had made FSC scheme and a special act, the FSC is deliberately being located outside of the U.S custom territory but it is under the U.S possession, because the location is outside the custom territory of US, so it cannot be taxed under U.S, but, still every trade activities are categorized as export performance. Further, for the special part in the act (Section 921(a)), the FSCs has the ability to not to pay taxes and (Section 245(c) IRC in conjunction with Section 926(a)) that the parent companies were allowed to delay or even avoid on paying taxes. Second, the ETI Act is subsidy that conditioned upon export performance, because the tax exclusion will be available only if the property/good is “for use outside the United States”, and this act is continuing the FSC’s scheme from the Internal Revenue Code by ruling the tax exclusion only available outside the custom territory of the U.S. Third, inside of the AJCA, the ETI benefits remain available during the year of 2005 and 2006 under the AJCA article 101, and by only continuing the function of the ETI Act, therefore the AJCA is also included as the legislation that categorized as prohibited subsidy. By that violations, WTO calculated that Boeing receives \$2.199 billion from the tax exemption that made by U.S government.

B. RECOMMENDATIONS

1. The reality that occurred in the WTO is that there were still many Members who did not pay attention to the SCM Agreement on the obligation to send notifications. Therefore, there are still lack of transparency and it gives burden to the Committee, since the Committee could not conduct their task maximally because of the Members who do not send their subsidy notifications, by this the control of the subsidy under the WTO will be hampered. Therefore, the writer recommends Member State of WTO to obey the rule under the SCM Agreement on sending notifications, for the sake of good and transparent world trade.
2. The writer recommends every state to avoid any kind of violation on international trade. From the violation conducted by the U.S, trade system that is not accordance with the international rule will burden the state itself, because the other Members will be able to sue under the WTO DSB to make the violator changes their trade system to be in accordance with the international rule, when it still not in accordance, the WTO will always make recommendation to the state to comply with the international rule. Additionally, the writer also recommends WTO to make the SCM Agreement stricter and forceful towards the decision of the WTO DSB. From the case above, United States tend to ignore the recommendation from WTO because there is no sanction given if US does not comply with the recommendation.

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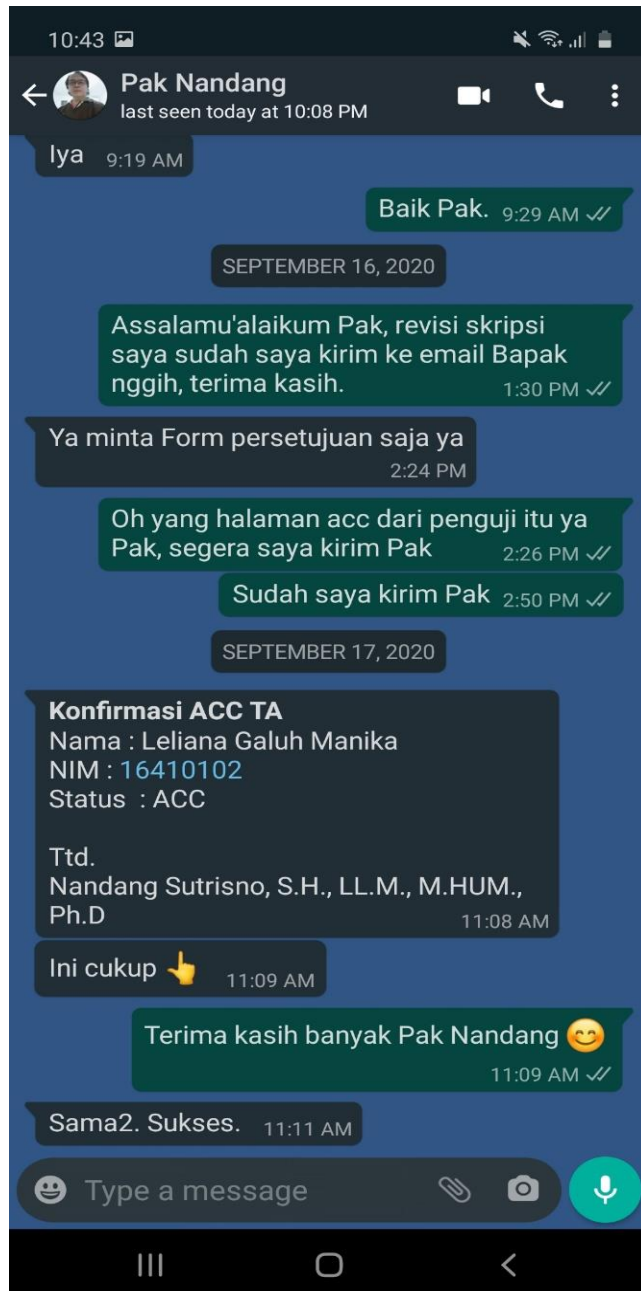
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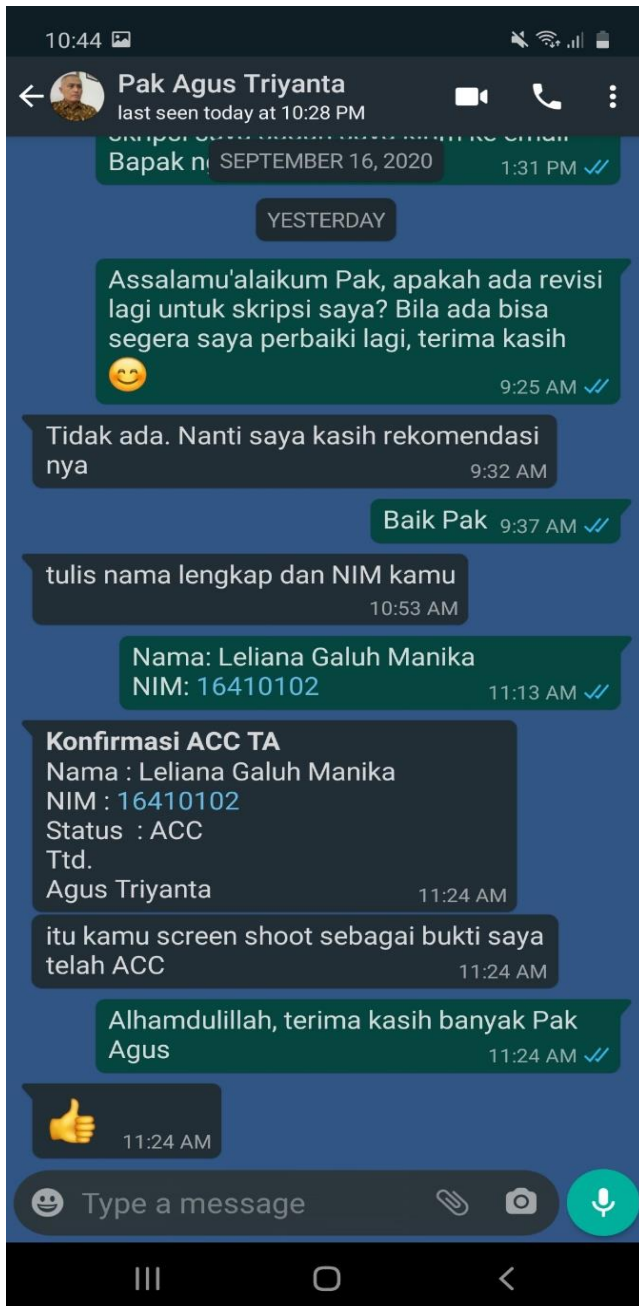


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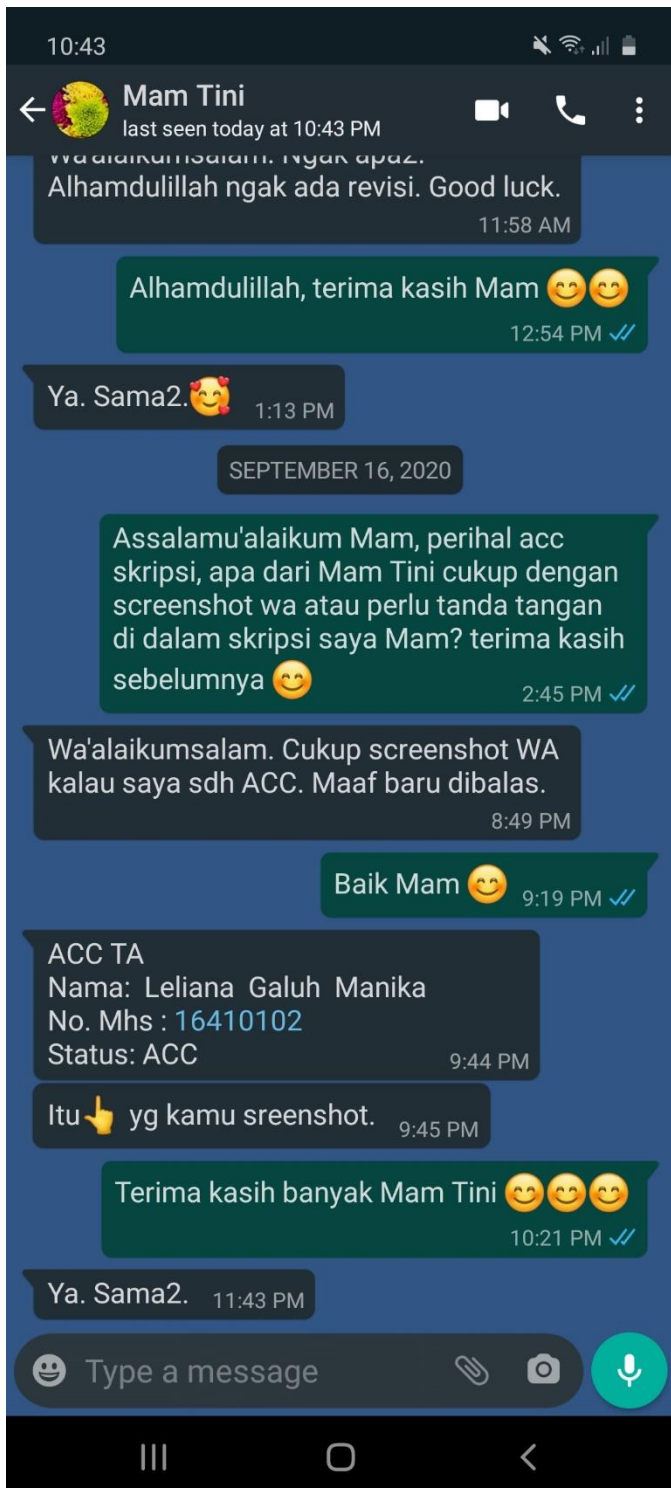
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