Trade disputes in the commercial aircraft industry: A background note

A specialist paper by the Royal Aeronautical Society

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SUMMARY

The long-running debate between the US and the EU over government supports for large commercial aircraft has recently boiled over into a major dispute involving the World Trade Organisation (WTO). While the two sides have currently backed off from what could be a very damaging WTO outcome, there are still wide differences over the legitimacy of government supports (direct or indirect) for Airbus and Boeing airliners. This paper:

- Describes the background to the current dispute
- Analyses the 1992 US–EU Agreement on Large Aircraft Subsidies
- Outlines the WTO Agreement on Subsidies and Countervailing Measures and the decision by the US to mount an action under the WTO complaints procedures against launch investment for Airbus and the EU’s counter claim against Boeing
- Considers the precedents set by the WTO rulings on the Brazilian–Canadian dispute over regional jet supports
- Summarises the US–EU complaints to the WTO
- Considers potential outcomes and the implications for the civil aerospace industry on both sides of the Atlantic
- Analyses the wider issues surrounding government intervention in the aerospace sector

The paper views the dispute as a reflection of fundamental differences, based primarily on divergent economic doctrines and values, between the US and the EU states. There could be especially damaging consequences for the EU should the WTO rule against the systems of repayable launch investment used by the Airbus governments. But both sides could lose heavily from the affair and there is a good case for maintaining some form of direct government intervention in civil aerospace technology acquisition, even near market research, in support of environmental sustainability objectives.
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CONTENTS

Glossary ................................................................................. 4
Introduction .......................................................................... 5
The Airbus–Boeing dispute .................................................. 5
The 1992 agreement ............................................................ 5
Showdown at the WTO corral ............................................. 6
The WTO and subsidies ....................................................... 7
The WTO and regional jets .................................................. 7
The WTO principles and process ......................................... 8
US and EU cases ................................................................... 8
Outcomes .............................................................................. 9
A clash of political–economic values .................................. 10
Alternatives .......................................................................... 10
An evolving story ............................................................... 11
Final words — for now ........................................................ 12

GLOSSARY

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>AECMA</td>
<td>(See ASD)</td>
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<tr>
<td>AIA</td>
<td>Aerospace Industries Association (US)</td>
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<td>ASD</td>
<td>Aerospace and Defence Industries Association of Europe</td>
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<td>ASCM</td>
<td>Agreement on Subsidies and Countervailing Measures</td>
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<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
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<td>MDD</td>
<td>McDonnell Douglas</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>TPC</td>
<td>Technology Partnerships Canada</td>
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<td>WTO</td>
<td>World Trade Organisation</td>
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1.0 INTRODUCTION

1. The aerospace industry can be viewed as a “textbook example of an industry where governments use trade policy to alter the strategic interaction between the domestic firm and the foreign rival with the goal of shifting market share and profits from a foreign to a domestic firm.”

The case of the long-running dispute between the US and the EU over government supports for Airbus and Boeing airliners also reflects a clash of philosophies about the limits of state intervention, further complicated by the links between state support for a vital defence industry.

2.0 THE AIRBUS–BOEING DISPUTE

2. The current Airbus–Boeing dispute stems from the industrial launch of the A380 in 2000 but has a long pre-history stretching back to the late 1970s and Airbus’s first successes in penetrating the US market helped by generous export supports from the French and German governments. The accusations and counter-accusations have an equally long pedigree with examples drawn from cases now stretching back over 40 years. Many of the detailed arguments detailing the extent of government supports and their supposed market distortions are derived from partisan analyses published in the early 1990s.

3. Both sides have received government support whether directly or indirectly but it is difficult unequivocally to prove whether either party has benefited in terms of national welfare. According to one economic analysis, the entry of Airbus has generally been beneficial for international competition, where modelling suggests that aircraft prices would have been 40% higher without Airbus’s entry in the late 1970s and has been increasing over time despite increasing market concentration (the emergence of the Boeing Airbus duopoly). Crucially, from a US perspective, this has resulted in lower prices and increased competition for consumers.

3.0 THE 1992 AGREEMENT

4. In 1992, after a period of mutual sniping and threats, the US and the EU negotiated a bilateral Agreement covering the development of large (more than 100 seats) airliners. The immediate context was shaped by the breakdown of negotiations between Airbus and McDonnell Douglas (MDD) over a joint programme and the subsequent launch of the A330/340. The 1992 Agreement was the first instance of the European Union acting on behalf of the Airbus governments in respect of trade questions. This was new terrain for the individual governments and differences of opinion were noticeable, with the British and the Germans less militant than the French, fearing ramifications affecting other trade issues and wider political relations with the US. The French, however, were especially robust and prepared to launch retaliatory sanctions if the US took unilateral action. However, the Commercial Aircraft issue was also bundled up with other GATT negotiations over agricultural subsidies where the EU and especially the French were eager to reach agreement with the US.

5. The 1992 Agreement resolved temporarily a number of contentious issues about support practices and defined the scope of others:

- It prohibited production subsidies
- Limited the use of sales supports to the OECD Large Aircraft Sector Understanding
- Limited direct government support to 33% of development costs
- Support could only be given to projects likely to repay the loan within 17 years
- The first 25% of total development costs had to be repaid at the government’s borrowing rate
- The remaining 8% had to be repaid at the government’s borrowing rate plus 1%
- Repayments were to be based on a per-plane basis rather than at the end of the loan
- Indirect supports were limited to a maximum of 4% of annual commercial sales of a firm or 3% of industry-wide annual commercial sales in each country
- In exceptional circumstances where the survival of a significant part of the civil aircraft manufacturing industry and the continued financial viability of a company were responsible for such manufacturing was in jeopardy, derogation from the Agreement was permissible.

In order to reduce the risk of retaliation, the US and the EU agreed to monitor implementation and to try to resolve disputes through consultation. Either side could abrogate the agreement if the other side failed to comply with its terms.

6. In the view of some contemporary observers, it was felt that the US achieved more from the 1992 Agreement than the EU. As Don Fuqua of the US trade association, AIA observed: “Our major...
objectives were achieved.”7 While the US accepted for the first time the principle that their aerospace industry benefited indirectly from NASA and DoD programmes support, the EU abandoned production subsidies and accepted formal constraints on repayable launch investment programmes. While the issue of production subsidies was already causing disquiet within Europe it was nonetheless an important concession8. More important, the Agreement prevented Airbus from receiving more than 33% of non-recurring costs in repayable launch investment when in the past some government loans had been as high as 100%. In return, the US accepted largely unquantifiable and unverifiable limits on its indirect supports.

4.0 SHOWDOWN AT THE WTO CORRAL

7. The following year, the GATT (later WTO) concluded a general Agreement on Subsidies and Countervailing Measures (ASCM). While this specifically excluded commercial aircraft, the US felt that this had precedence over the 1992 Civil Aircraft Agreement. The Europeans, on the other hand, stood by the 1992 Agreement. In some respects, the ambiguity of language and different viewpoints on the status of the two agreements enabled both sides to feel satisfied with the outcome. Ambiguity is only sustainable until one side decides to test the strength of argument in open court. At the time and for several years afterwards, neither side was ready to clarify the exact status of either the 1992 Agreement or the applicability of the 1993 GATT-WTO subsidy code, primarily because by the mid 1990s the industry globally was facing very hard times. During the 1990s, industry attention was focused on surviving the steep simultaneous downturn in the defence and civil market cycles. It was a period characterised by rapid industrial restructuring, especially in the US.

8. However, the underlying debate over civil airliner subsidies continued to simmer. In the interim, both sides continued to collect evidence and to hone arguments. The US was reluctant formally to declare the extent of indirect support. For its part, the European trade association AECMA (now ASD) undertook its own study estimating the extent of general US aid to civil aerospace through defence R&D and other programmes. Industrial consolidation in the US and the emergence of an independent and commercially successful Airbus also tended to sharpen the debate, mitigated to some extent by the growing interpenetration of supply chains and wider investment by US and European companies in each other’s market.

9. The origins of the current crisis lie largely in Boeing’s steady loss of market share to Airbus and, specifically, the launch of the A380. Boeing argued that the project lacked commercial justification without subsidy and as such was in clear breach of the 1992 Agreement10. For its part, Airbus felt that Boeing’s initial answer to the A380, the Sonic Cruiser, although subsequently cancelled, had benefited extensively from NASA programmes the results of which would still benefit the Boeing 787, a less ambitious but still advanced design that Boeing had begun to offer as the basis of its 21st century civil programme11. 10. US concerns were first publicly raised at the 2000 EU–US Summit12. However, the immediate timing of the US’s appeal to the WTO, though threatened throughout the spring and summer of 2004, surprised even US industry observers13. From 2000, despite continuing efforts on the EU side, US trade representatives had declined to meet to discuss issues in accordance with the 1992 agreement. In May of 2004, however, they approached the EU for a meeting, which took place on 22 July 2004. The US demanded an immediate ending of repayable launch investment and for a ‘line to be drawn under the issue’. They offered no concessions themselves and dismissed concerns aired by EU representatives about US practises in general and counter claims about US and overseas support for the Boeing 787. At further meetings in September 2004 the US continued to raise the temperature on the issue. At this stage the threat to Boeing had featured in both the Bush and Kerry presidential campaigns, and the EU representatives began to question whether US efforts represented more than political grandstanding.

8See Hayward, K. op cit. 9Germany was especially generous with production subsidies, whereas the UK government provided none. 10Pavcnik argues on the basis of a range of simulations that, while the A380 is likely to repay its development costs, profitability is more uncertain. However, the rate of current orders for the A380 is more promising and Airbus claims to be well ahead of schedule to break-even. 11The 787, formally known as the 7E7, is also referred to as the Dreamliner. 12The WTO had just ruled against the US FSC tax break for exporters, as one of the most important US exporting companies, this cost Boeing a considerable amount of money. 13Harry Stonecipher’s character and torrid experiences with MDD’s civil business and Boeing’s increasingly weak commercial position may well have been the trigger for the US WTO submission. In particular, Airbus was set to launch the A350 as a counter to the 787 and would undoubtedly seek launch investment from the partner governments. The loss of the USAF’s tanker order, threatening closure of the 767 line following the Druyan contract scandal, may also have pushed Boeing into confrontation. Certainly, growing disquiet over Boeing’s overall commercial strategy and its increasing vulnerability was increasingly evident.
11. On 6 October the US formally filed with the WTO for consultation on an alleged breach of the ASCM and abrogated the 1992 Agreement declaring that the EU were in breach of Article 10. The ASCM complaint was filed both against the EU and the four member countries involved, France, Germany, UK and Spain. Each member nation was expected to participate and to provide supporting evidence as and when required. The EU rejected the US grounds for terminating the 1992 Agreement and responded with a counter complaint.

5.0 THE WTO AND SUBSIDIES

12. The WTO broke new ground in 1993 with the ASCM agreement by defining what was meant by a subsidy. Equally, by specifying Countervailing Measures, it determined means to offset injury caused by subsidised imports once a WTO dispute settlement process had been completed. The ASCM definition of subsidy has three elements: a financial contribution, by a government or public body within the state and which confers a benefit. All three elements must be present in order for a subsidy to exist. A financial contribution may comprise: transfer of funds or liabilities; forgoing revenue (e.g. tax credit); providing goods and services (other than general infrastructure); or entrusting a private body to conduct the above and so confer a benefit. However, a subsidy is actionable only if it has been specifically provided to an enterprise or industry or groups of enterprises or industries. Specificity can also include regional subsidies directed at industries or enterprises. There are two basic categories of subsidies: those that were specifically prohibited and those that were actionable (the latter are subject to challenge under WTO procedures).

13. The ASCM did not ban subsidies as such; it simply sought to differentiate between specific aids to companies or industries that were intrinsically protectionist or unfairly promote exports of goods and services, and general support for societal or economic development. These could include intervention to redress regional economic disadvantage, aid to facilitate restructuring of certain industries and to encourage general R&D. The latter could also include infrastructure and investment designed to comply with new environmental regulations. In short, subsidies are ‘bad’ if they demonstrably tilt the ‘level playing field’ of international trade. The US did not seek an even more restrictive agreement if they demonstrably tilt the ‘level playing field’ of international trade with new environmental regulations. In short, subsidies are ‘bad’ if they demonstrably tilt the ‘level playing field’ of international trade. The US did not seek an even more restrictive agreement if they demonstrably tilt the ‘level playing field’ of international trade. The latter could also include intervention to redress regional economic disadvantage, aid to facilitate restructuring of certain industries and to encourage general R&D. The latter could also include intervention to redress regional economic disadvantage, aid to facilitate restructuring of certain industries and to encourage general R&D. However, a subsidy is actionable only if it has been specifically provided to an enterprise or industry or groups of enterprises or industries. Specificity can also include regional subsidies directed at industries or enterprises. There are two basic categories of subsidies: those that were specifically prohibited and those that were actionable (the latter are subject to challenge under WTO procedures).

14. The WTO rulings on the Canadian and Brazilian government support for regional jets were the first cases specifically involving commercial aircraft, and provided ‘interpretation for many of the rules applicable to export subsidies’. It also considered the provisions related to special and differential treatment for developing countries. Although the WTO works on a case-by-case basis, the two cases were linked politically if not legally. The dispute hinged on the use by both Brazil and Canada of export subsidy mechanisms that were subsequently declared illegal by the WTO. Brazil complained about six Canadian support schemes while the Canadian case focused on the Brazilian Proex export subsidy. Brazil admitted that Proex was indeed a subsidy and that a benefit was conferred on Embraer. However, the Brazilian government asserted that Brazil’s status as a developing country and aerospace’s position as an ‘infant industry’ justified a subsidising policy. However, the WTO ruled that developing economy status did not afford full exemption from the prohibitions on direct export subsidies.

15. More relevant to the current US–EU cases, the Canadian justification for its support policies, including the TPC scheme, was effectively a test case of ‘benefit’ under WTO rules. The Canadian government argued that as there was no net cost resulting from the TPC programme, there could be no benefit to Bombardier. Nor was it specifically aimed at subsidising exports. The WTO panel ruled, however, that Bombardier did obtain direct benefit as the TPC format facilitated development of a product aimed at world markets. As such it was implicitly, if not explicitly, a distortion of world trade. The crux was that the recipient of the support had clearly obtained benefit even if the Canadian taxpayer had not lost out since Canadian state funding programmes were more favourable than funding offered by the market. In short, the TPC scheme provided aid too close to the market even though it entailed no net cost to the government.

16. This interpretation might have implications for other developing aerospace industries such as China when it is fully integrated into the WTO.
State support was only valid where the outcome was uncertain where there was no immediate prospect of exports. Government support for generalised, especially not sector specific, technology acquisition was permissible. Interestingly, the Canadian export credit system was not ruled as a subsidy because the margins were commercially based and the system was open to all Canadian exporters.

16. The Canadians have since tinkered with the TPC system to make it less sector specific. Similarly, changes to the Brazilian Proex scheme have made it WTO compliant. But in essence the outcome of the dispute is still in limbo, with $3 billion in trade sanctions hanging in the air and no fundamental change to the ‘subsidy’ policies on either side. Goldstein and McGuire suggest that WTO involvement, having raised the costs of losing, may have lead both governments to conclude that the costs of compliance were too high if this meant reversing several decades of industrial and technology policy favouring an export-orientated aerospace sector. Nevertheless, the implications for the EU–US case and potential WTO rulings are telling. The key issues were what was the intent of the subsidy and how targeted was it. A clear implication of this ruling was that repayable launch investment programmes, even if they brought returns to the public investor if limited to an industry or company, could fall foul of the WTO’s definition of benefit and sector specificity.

Significantly, the EU supported the Canadian position during the appeal process, whereas the US backed the WTO Panel’s initial ruling.

7.0 THE WTO PRINCIPLES AND PROCESS

17. The WTO dispute resolution process requires an initial 60 day consultation period between the involved parties beginning on the date of filing (in this case 6 October 2004). This period may be extended by mutual consent. Once in place, panels are required to report to the parties concerned within six months and to the Dispute Settlement Board within nine months. In the Airbus–Boeing case, the first consultation meeting took place in Geneva on 4/5 November, with an exchange of requests from both sides for details of procedures and citations of breaches of the WTO subsidy code. The WTO needs proof of damage, a measurable injury to competitors, before government assistance can be called a subsidy. Boeing claimed that its loss of more than 20% market share since 1992 was clear evidence of damage; Airbus again cited the extensive impact of US indirect subsidies.

8.0 US AND EU CASES

The A380

18. Unlike the Brazil–Canada dispute, the US case against A380 does not clearly fall under the 1994 subsidy code that outlaws export supports. However, it could contravene the WTO requirement to support projects that are in line with the practises of private investors in a country. The US position has been strengthened to the degree that the success of Airbus in winning market share has undermined any ‘infant industry’ justification. The US claimed that EU support for the A380 contravenes both the 1992 Agreement and the 1994 WTO Subsidy code. However, the EU asserts that the support advanced for the A380 conforms to both. A key issue is whether the project is likely to repay its loans within the 17 years specified in the 1992 Agreement. The US contended that, as the government investment would be paid back only if the A380 was commercially successful. Airbus faced a much-reduced level of risk. The US also cited some $1 billion in infrastructure investment made by the Airbus governments to support A380 production as an example of regional specificity. The US argued that as repayments are based on the per-plane principle, Airbus has no financial liability to governments if it fails to sell a sufficient number of A380s. As such, this form of subsidy was prohibited by the 1994 Agreement. Launch investment policies violate ‘the principles of a competitive market in which the owners of a company must accept the risk of failure in the market place’. Thus Boeing asserted that Airbus has used this advantage to build a family of aircraft in a shorter time than if it had been dependent on ordinary commercial sources of funding. Indeed, Boeing claimed that Airbus has avoided some $35 billion of commercial debt through repayable launch investment.

The Boeing 787

19. The EU’s counter case focused on public support advanced by Washington State and government investment by Japan and Italy. Washington State has granted Boeing (technically, any company) substantial tax incentives to ‘site a significant commercial airplane final assembly’ facility in the state. The legislation specifically defines a large, twin-aisle, super-efficient commercial aircraft and production rate requirements for eligibility. Other inducements cover all Boeing aircraft and for aircraft components produced in the state. Washington is also considering some infrastructure improvements in support of 787 production. Kansas and Oklahoma also introduced incentive packages to attract Boeing assembly work. As a prospective ‘national project’, Japan is considering a repayable launch investment package to finance a five-company consortium bid for a 35% workshare, including the vital wing box development. Loan repayments will be set according to Japanese domestic interest rates. The Italian government has indicated that it will invest in upgrading Alenia facilities to meet its commitments to a 13% share. In total, Pritchard and MacPherson estimate that Boeing’s contribution to

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21In the case of the UK, its RPI system is not only unique to aerospace but it has also been conventionally granted to a limited number of companies at the top end of the supply chain, in recent years, mainly Airbus and Rolls-Royce.
23The dispute has also been found on: http://docsonline.wto.org/DDFDocuments/t/G/SCM/D62-1.doc and http://docsonline.wto.org/DDFDocuments/t/G/SCM/D63-1.doc
24Carbaugh and Olienyk, J., op cit, p 4.
25Pritchard and MacPherson, op cit, pp 66-68. The US argues that state level tax breaks are available to all aerospace companies in Washington, even Airbus suppliers.
20. While the A380 is the focus of their case before the WTO, the primary intent of the US was to draw a line generally through European launch investment mechanisms and specifically potential government support for the A350. Initially, encouraged by the strength of their case and the political pressure generated by Boeing, the US appeared to be ready to take the dispute into unknown territory in order to force the EU finally to end its collective position on direct support for commercial aircraft. The interpenetration of supply chains and relative importance of each other’s markets was well appreciated by both parties but discounted in the dispute. However, if the US intended to force the EU to compromise, it was hard to discern a what their fall back position was — a continuation of launch investment in principle but at a very much higher rate of return, or phased repayment rather than per-plane? This would be hardly acceptable to the Airbus partners, as such a deal would tend to remove the very advantages of launch investment schemes. On the other hand, it’s hard to see a return to conditions before the 1992 Agreement. For its part, with the A380 launch investments ‘grandfathered’, Airbus stated that while the A350 could be financed privately, if launch investment was still available, there was no reason why it should not continue to take advantage of it.

21. In the short term, sharpened by the prospect of a mutually damaging WTO twin ruling, much will depend upon shifting assessments of the costs of compliance versus the costs of non-compliance. While important to both the US and the EU economies, neither Boeing nor Airbus has the relative standing of Embraer or Bombardier (although both Airbus and Boeing do have an important real and symbolic positions in their respective

22. For its part, the UK government remains confident in the strength of the EU case. In particular it believes that there is no solid grounds for arguing a breach of Article 10 of the 1992 Agreement. There was some skepticism about the levels of understanding on the US side, in particular regarding the nature of repayable investment. Over the past decade or so, the returns generally from launch investment to the UK government have been positive and its investment in the A320 has been particularly profitable. With this record, it is hard to define launch investment as a subsidy, but the questions of benefit and specificity the heart of any WTO judgment may be more problematic. Launch investment as a scheme is unique to aerospace in the UK and has been confined to a few firms, notably Airbus (or BAE Systems) and Rolls-Royce.

23. There is a risk of collateral damage to other parts of the UK aerospace industry. While the current dispute focused on large commercial aircraft and all WTO cases are separate, a negative ruling would leave other launch investment decisions exposed. Rolls-Royce and Bombardier Northern Ireland have or are seeking launch investment. Rolls-Royce has received substantial levels of UK government investment, again with returns to the Treasury. In the past, US engine companies have been muted in their opposition to direct government support but GE has complained about the prospect of Rolls receiving launch investment for the Trent 1000 aimed at the 787. The French have hinted that they might extend their repayable investment scheme to other industries, anticipating perhaps the need to end industry specificity. Nevertheless, the European aerospace industry has probably more to lose than the US if the WTO rules against repayable support schemes.

24. On the other hand, the US may be beginning to appreciate the dangers if the WTO did find against both parties. Whereas the US is focusing on a possible European programme (the A350) and the sins of past investment (A380), the EU is attacking a ‘live’ programme, the 787. Boeing has much at stake with the 787 as its first new civil programme in over a decade and conceivably, its
last chance to regain commercial ground lost to Airbus. The programme structure and management is also a radical departure for Boeing, using a systems integration approach co-ordinating the design and development activities of its team of multinational risk-sharing partners. This has the risk of ‘hollowing out’ Boeing’s overall competence as a complete aircraft manufacturer, but it has substantially reduced the financial risk of developing the first of what is designed as a sub family of airliners. If the regional and national supports afforded to Boeing and its partners in Japan and Italy were ruled non-compliant by the WTO, there might be serious repercussions for sales with potential customers deterred by the uncertainty generated by a negative ruling30.

25. The lines of argument put before the WTO by the US and the EU are in general much the same as debated endlessly over the past 20 years. If the WTO is pushed to rule on the US–EU complaints, both sides are likely to ‘win’ their cases. The problem then would be to assess who would stand to gain or lose the most in what at best would be a very messy outcome. The Airbus–Boeing case could produce a similar limbo-like outcome to the Canada–Brazil affair, with several $ billions of ‘fines’ left hanging in the air. Given the uncertainty that this might engender, it would not be the best of conditions for the world civil aerospace industry.

10.0 A CLASH OF POLITICAL–ECONOMIC VALUES

26. The WTO ruling on the Canadian Technology Partnerships (TPC) support for Bombardier was described as a ‘clash of philosophies’. While the WTO is about legal norm setting and establishing agreed regulatory frameworks, its process remains highly politicised, reflecting persistent national perceptions and differing economic value-systems. Subsidies pose a number of problems for trade regulation — primarily because in certain circumstances they can be both necessary and desirable. These can relate to market failures, for example to promote fundamental research that may lead to environmental gains or as a feature of economic policies for developing states seeking to improve international competitiveness. The issue is what defines a ‘bad’ subsidy31.

27. The EU, Japan, Canada and Brazil have traditionally taken a much more permissive view of state intervention. In the language of trade policy, they have adopted a ‘structuralist’ standpoint compared to the neoliberal position assumed by the US32. It its evident, however, that the underlying trend, even within the EU, has been toward greater liberalisation. Individual EU members, evident, however, that the underlying trend, even within the EU, has been toward greater liberalisation. Individual EU members, notwithstanding the possibility that they may not achieve the necessary consensus33. Decades more practice would be required to establish the complex of channels and processes that allow industry routinely to internalise and exploit the links between civil and defence activity. And it should be noted, technology is not the only factor separating the US from the EU approach to aerospace support — differing levels of return from defence contracting, for example, has afforded the US industry decades of comparative advantage.

30. The US could adopt more European structuralist formulae; indeed, technology policies under the Clinton Administration exhibited a strong flirtation with EU and Japanese models38. Although domestic opinion might be divided, there are precedents, US government support has been forthcoming for Lockheed, Chrysler and domestic airlines, albeit in emergency conditions and, in the first two cases, with full pay back on Federal loans. A US launch investment scheme (or more likely, an emergency budget line for NASA aeronautical research into large airframes) may be feasible if the political will was strong enough. As one US analyst put it in testimony to the House of Representatives: “The new trade theory indicates that the most effective US response to Airbus — both in terms of helping US industry to compete and in inducing the Airbus governments to

28. From the outset, the US–EU dispute over large commercial aircraft has revolved around conflicting ideologies of technological and industrial policy. As the Christian Science Monitor editorialised: “On the surface, the dispute appears to be about boosting jobs and exports. But really it’s a magnification of the European–US culture clash over the role of government.”34 The scale and scope of Airbus’s climb to first place in the world commercial aerospace market in many respects vindicates the ‘European’ philosophy. Equally, much of Boeing’s fall from grace could be ascribed to poor corporate strategy, inadequate investment in civil research and the vulnerability of a notoriously long-term business to rampant shareholder value35. As Will Hutton puts it in a vigorous defence of the Airbus ‘way’, a strategic approach is justified in this type of industry and has delivered more value in the round than Boeing. The US model should not necessarily be regarded as the global standard for advanced economies and for promoting the general public good36.

11.0 ALTERNATIVES

29. It is open for both sides to adopt either’s mechanisms. But in the case of Europe approaching US practise, this is akin to saying everyone can stay at the Ritz. Practically, the EU would have to achieve levels of integration in both civil S&T programmes and defence R&D comparable to the Federal US Government even to reach equity of potential. Even though NASA funding for aeronautical research has been in decline, it is still higher than the total EU (+ the Airbus national government programmes) equivalent for civil research. Shifting to an indirect model would depend upon the wider politics of EU budgeting and, while the Airbus states represent a large chunk of the Union, they may not achieve the necessary consensus37. Decades more practice would be required to establish the complex of channels and processes that allow US industry routinely to internalise and exploit the links between civil and defence activity. And it should be noted, technology is not the only factor separating the US from the EU approach to aerospace support — differing levels of return from defence contracting, for example, has afforded the US industry decades of comparative advantage.

30. The US could adopt more European structuralist formulae; indeed, technology policies under the Clinton Administration exhibited a strong flirtation with EU and Japanese models38. Although domestic opinion might be divided, there are precedents, US government support has been forthcoming for Lockheed, Chrysler and domestic airlines, albeit in emergency conditions and, in the first two cases, with full pay back on Federal loans. A US launch investment scheme (or more likely, an emergency budget line for NASA aeronautical research into large airframes) may be feasible if the political will was strong enough. As one US analyst put it in testimony to the House of Representatives; “The new trade theory indicates that the most effective US response to Airbus — both in terms of helping US industry to compete and in inducing the Airbus governments to

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change their behaviour — may be to provide similar types and magnitudes of financial support to its industry. This would represent a shift of US policy from reliance on negotiation to limit government subsidies of Airbus.” 39 Another US commentator, while rejecting the European approach, suggests a ‘sphere-of-influence’ approach comparable to the chemicals industry in the first half of the 20th century. Airbus and Boeing would have the run of their domestic markets protected by tariffs. In third country markets they would compete on level terms, which would provide incentive for efficiency 40.

31. Given the current administration’s economic viewpoint, a more palatable solution from a neo-liberal perspective would be attempts to strengthen the existing anti-subsidy regime. A former Clinton administration appointee has advocated a new version of the 1992 Agreement expanded to include Japan and with provisions for others at a later stage. There would have to be transparent accounting of all supports based on US or international standards. A reducing ceiling on supports should be negotiated. The Agreement should have clearly defined penalties for violation. The Agreement should be ‘policed’ by an independent overseer 41.

32. All of these ‘alternatives’, however, fail to address the fundamental problem of ‘indirects’ which, by their very nature, are impossible fully to quantify as ‘benefits’ and may simply escape monitoring. There is a built-in preference, naturally enough perhaps, towards a US vision of what is an appropriate role for the state in commercial aerospace. The introduction of tariffs of any description would be retrogressive and potential damaging to the already weak airline systems of the US and Europe. In any case, as the US airline market is far larger than the European, reserving it for Boeing would confer a signal advantage. It also seems that ‘third’ parties such as the Japanese are more than a touch reluctant to embrace the 1992 Agreement. Japan has already made it clear that it would not take part in the negotiations appearing to rule out inclusion of third party supports in any agreement between the US and the EU 42.

12.0 AN EVOLVING STORY

33. By January 2005 there were signs that the heat might again be going out of the dispute. The newly appointed EU Trade Commissioner Peter Mandelson, while pressing hard the Airbus position, agreed with the outgoing US trade representative Bob Zoellick to suspend the WTO process while the two sides negotiated the elimination of all civil aircraft subsidies. As Zoellick observed, this “marked an important step in trying to end subsidies for large commercial aircraft. For the first time in this long-standing dispute, the US and the EU have agreed that the goal should be to end subsidies. To sharpen the focus of our work, we have further agreed to use the definitions and framework of the WTO subsidies rules as the basis for an agreement. This approach should also help us to multilateralise the effort over time.” 43 For his part, Peter Mandelson stated that Airbus was now “clearly capable of competing in the global market place” without further public financing. Negotiations were to last for three months, covering “the different types of support affecting the sector in a balanced manner, elaborating upon the scope of subsidies as defined by the WTO.” No new government support for large civil aircraft was to be granted during this period, which could be extended 44.

34. However, the legacy of the past decades of dispute was hard to shake off. The EU Commission said that the detailed list of subsidies covered by the negotiations will be “a difficult issue”; and as Mandelson himself put it: “What is one man’s launch aid is another man’s subsidy.” In view of the “colossal risks” in developing commercial aircraft, he observed that “there is no way you would take the risks involved in that sector without some form of government guarantee.” 45 Somewhat provocatively, and despite the standstill on launch investment, Airbus announced that it still intended to apply albeit at a lower level, for the A350 as a means of ‘preserving (Airbus’) rights’, a request that would be left on the table during the US–EU talks 46. However, an Airbus official hinted that Airbus might be willing over time to forgo launch investment if the EU could sustain a comparable level of indirect support US industry obtains from NASA 47. For its part, Boeing remained convinced that it had a solid case before the WTO and that the aim of the negotiations should be to remove launch investment from scene 48.

35. In late March, the talks seemed to have foundered, with the US appearing to reject the EU’s ‘step-by-step’ process that included Japanese support for the 787. But over a weekend, both sides hastened to assure the world the talks were still on with the EU agreeing to seek a bilateral deal with the US before any question of widening its scope. Nevertheless, the EU would defend launch investment policies until it was satisfied the US was offering a comparable set of concessions. This will go to the wire, and while a deal is possible, there is a danger that the WTO process will roll into action, particularly as the EU has the most ground to give up, unless the US backs off to the status quo ante. As a Commission spokesperson put it, “launch aid is all we have.” 49

39Richard Golaszewski, Executive VP GRA Inc. House of Representatives, Committee on Science, Subcommittee on Space and Aeronautics, 7 March 2002.
40FINGLETON, op cit p 13.
41Jeffrey Garten ex under secretary of commerce for international trade, Financial Times, 10 January 2005.
13.0 FINAL WORDS — FOR NOW

36. The Boeing–Airbus dispute not only reflects a battle for market share in high value goods but is also about competing views of the form or even the appropriateness of state engagement in high-technology industry. In some respects this issue is almost as old as the industry. Although the Wright Brothers tried to avoid government, few that followed have been so punctilious. What makes this particular round so interesting is the fact that civil aerospace has been edging and nudging towards disengagement with Politics with a capital ‘P’. Airbus is no longer a national coalition allocating business according to national work shares. It now organises its production along tight, commercially driven principles. The airline market place has also lost some of the more brutal features of state intervention.

37. Nevertheless, this industry is still ‘different’ compared to, say, automotive. While national security hovers over half the industry, there will always be ‘special interests’ shaping industrial structure and process and technology will inevitably leak from defence programmes to civil. On the demand side, while many of the major airlines still operate in a wonderland economy, bolstered by controls on market access, ownership, various legal boltholes to avoid complete bankruptcy, and bits of state aid, the civil aviation industry at large will never be fully ‘liberalised’. Structuralism, implicit or explicit, will be hard to erase in this sector. Nevertheless, there is continuing undercurrent of change, particularly on the European side and perhaps led by the UK, where the trend is towards a more ‘indirect’ style of state intervention. However, the transition is likely to be protracted and largely dependent on the emergence in Europe of a more integrated approach defence-aerospace R&D and certainly an expanded European research budget.

38. In the meantime, the EU and other structuralist economies will continue to view government intervention in strategic industries such as aerospace as providing net benefits to consumers, as answers to market or capital market failures or simply reflecting a fundamental view of what comprise proper and prudent economic policies. It would not be surprising to see this approach tied to the environmental challenge; to enlist proven mechanisms to promote technological innovation in the search for sustainable aviation solutions50. This is something a more enlightened and rational US administration might also recognise as a sensible way to move forward51. The WTO would probably view this as a permitted subsidy with public funding directed at delivering a public good. While there would be undoubted commercial benefit issues, particularly first user advantages for a breakthrough technology, the civil aerospace industry must look to international solutions to a fundamental problem that could undermine market growth with detrimental effects for players on both sides of the Atlantic. A necessary first step must be to end the cycle of US–EU bickering and focus on mutually beneficial collaboration in technology acquisition.

50This is already evident to some extent in the approach to the next (7th) round of EU R&D funding under the Framework policy.

51Current trends in US policy are somewhat ambivalent: under pressure to make room for manned space, the NASA 2006 budget for aeronautics has again been cut (by 5% over 2005), but air traffic management, noise reduction and low emission energy generation remain priority areas for investment in long term, potentially ‘breakthrough’ technologies. The EU approach has been concentrated on more near market, product-related research. Both may not have got the balance right (see editorial in Flight International, 15 February 2005).