

AICGS ISSUE BRIEF

MARCH 2007

14

Boeing vs. Airbus:
The WTO Dispute Neither Can Win

BY ERIC HEYMANN

What instigated the WTO dispute between Boeing and Airbus?

.....

What agreements regulate the relationship between governments and the aircraft industry?

.....

What are the charges levied by each side against the other?

.....

How does the Boeing vs. Airbus dispute affect the aircraft industry on an international scale?

.....

What possible solutions to the dispute have been presented and how could they be reached?

In October 2004, the United States terminated the Agreement on Trade in Large Civil Aircraft it had signed with the EU in 1992. This agreement regulated the forms of government support for the civil aircraft industry (launch aid in Europe, indirect subsidies in the United States). At the same time, the United States initiated WTO dispute settlement procedures regarding subsidies to the European aircraft industry. In response, the EU initiated similar WTO proceedings against the United States. Since then, all attempts to get the two parties back to the negotiating table have failed. Nevertheless, both sides have reiterated their preference for resolving the matter without recourse to the WTO. However, the swift negotiation of a solution appears unlikely given the current relative market strength of the two rivals, the debate about increased state ownership of EADS, and the uncertainty surrounding the financing of the new Airbus A350. To put it in a nutshell, this transatlantic trade dispute has become bogged down.

The discussion surrounding subsidies in the civil aircraft market goes back to the 1970s and is thus almost as old as Airbus itself. The multilateral Agreement on Trade in Civil Aircraft (ATCA), negotiated in 1979, was signed not only by the United States and most Western European states, but also by other nations that are major players in the civil aircraft manufacturing business, such as Canada and Japan. The agreement was signed during a period in which Airbus had for the first time managed to capture significant market share in terms of orders and at the same time that high oil prices were giving the sector the jitters.

In essence, the ATCA prohibits the levying of import duties and quotas on civil airliners and on their parts and components. Technical trade barriers are also banned. Furthermore, the agreement was designed to reduce the influence of governments on airlines' purchasing decisions. However, the ATCA's provisions regarding the disbursement of subsidies to aircraft makers are very flexible.

The impact of the ATCA has been mixed: while the ban on duties, quotas, and technical trade barriers can be deemed a success, the governments on both sides of the Atlantic continued to exert major political influence over airlines' procurement decisions even after the agreement was signed. So, in many cases, the suspicion remains that governments have linked economic or military support for third nations with these countries' purchases of aircraft from the respective domestic manufacturer.

Subsidies and the 1992 EU-U.S. Agreement

The bilateral Agreement on Trade in Large Civil Aircraft between the United States and the EU was signed in 1992. At that time, the sector was suffering from the after-effects of the first Gulf War and higher oil prices; aircraft orders were at a cyclical low in the early 1990s.

The agreement, which regulated transatlantic relations in this sector for twelve years, does ban direct production and sales subsidies. However, its special significance lies in the fact that it legitimizes the standard methods used on both sides of the Atlantic to subsidize new projects in the aircraft industry. So on the one hand, direct state aid was permitted to cover a maximum of 33 percent of all the development costs for new aircraft. This so-called launch aid must be repaid with interest and the interest rate must cover at least the government's loan costs. Repayment is made over a maximum period of seventeen years depending on the sales of the respective airliner, i.e. only if the model is a commercial success. This reduces the financial risk borne by the aircraft maker. Launch aid is the standard form of assistance that the aircraft maker Airbus receives in Europe.

On the other hand, the agreement also permits indirect payments by the state to the aircraft industry and caps these payments at 3 percent of the sales volume of the domestic industry for large civil aircraft; subsidies of this kind do not need to be repaid. This form of state aid is practiced first and foremost in the United States, for example via research contracts for the military arm whose results are also used for the civil aviation side.

In hindsight, the legitimization of subsidies can be described as the gravest shortcoming of the 1992 agreement. The opportunity to declare the long-term reduction of subsidies in the sector as an objective was missed. Instead, state aid subsequently became standard practice for Boeing and Airbus.

WTO Called Back Into Subsidy Dispute in 2004

In October 2004, the United States terminated the bilateral agreement of 1992 and instigated WTO dispute procedures; this also meant that a lawsuit was filed against the EU and the four nations with Airbus stakes. The EU responded immediately to the termination of the agreement by the United States and also initiated WTO dispute settlement proceedings regarding U.S. subsidies for Boeing.

Presumably, the U.S. decision to withdraw from the 1992 agreement was influenced not only by the granting of launch aid for the A380, but also by the success of Airbus and Boeing's declining market share in the preceding years. In addition, the dispute was a topic of the U.S. election battle of

2004, with both presidential candidates attempting to paint themselves as defenders of American interests.

Failure at the Negotiating Table

Since October 2004, a series of attempts have been made to get the parties involved back to the negotiating table to try to reach a solution without involving the WTO. In early 2005, this appeared to have succeeded. By spring of the same year, however, the attempts had already failed because of talk in Europe about the possibility of state launch aid being granted for the construction of the new A350. Furthermore, by demanding an immediate stop to launch aid without offering corresponding concessions of their own, the United States set a precondition for the resumption of negotiations that was difficult for the EU to meet. Of course, the delivery delays at Airbus over the past two years and the company's resulting financial difficulties will also have tempered the willingness of the European side to resume negotiations.

A typical feature of the dispute is that both parties blame the other side for the failure of further negotiation efforts. Nevertheless, since October 2004, both the political representatives and the two companies have reaffirmed their fundamental willingness to reach a solution without involving the WTO.

A Long List of Accusations

Given the comprehensive accusations leveled by each side at the other over the past two years, however, a swiftly negotiated settlement appears highly unlikely, especially as in November 2006 both sides instigated further proceedings at the WTO. The most important charges that the United States has leveled against the EU include the following:

- Launch aid distorts competition to the detriment of Boeing and means a smaller financing risk and lower capital costs for Airbus. Launch aid has been granted for all Airbus aircraft to date.
- Sub-market interest rates, interest-free loans, and debt forgiveness by European governments (Germany).
- Additional financing from the European Investment Bank (EIB) on particularly advantageous terms.
- State support in expanding infrastructure in a variety of ways (primarily financial grants, provision of land for construction). This applies, for example, to the extension of the runway at Airbus' Hamburg facility for the A380 or to the construction of factories in France and Spain.
- Direct capital injections from the governments concerned.
- Research contracts as part of the civil aid programs for the European aviation and space industry.

The EU also stresses the negative impact on the European aircraft industry caused by U.S. subsidies, which it regards as unjustified. The main criticisms of the United States are:

- Indirect subsidization of the civil arm of Boeing via research and development contracts from the defence ministry, NASA, and other government institutions.
- Tax concessions and financial support from individual U.S. states (above all the state of Washington).
- Export promotion via various U.S. laws that provide or have provided export-oriented companies like Boeing with tax advantages (e.g. the Foreign Sales Corporation Rule and the Extraterritorial Income Exclusion Act).
- Export promotion via the Export-Import Bank of the United States (guarantees or loans for foreign customers); the bank is often also referred to as “Boeing’s Bank.”
- Launch aid from Japan for construction of the 787, since large parts of this plane are to be manufactured in Japan.

A Protracted Process

Both parties calculate that total subsidies running into the double-digit billions have been unjustifiably pumped into the aircraft industry of their rival. As such, the new 787 is described in Europe as the world’s most heavily subsidized civil airliner for being on the receiving end of USD 6-7 billion of aid. Of course, no stone is left unturned in attempts to refute the accusations. The United States does not regard military contracts as subsidies for Boeing. The EU points out that launch aid for aircraft has been paid back with interest by Airbus up until now.

In view of each party’s comprehensive and complex list of accusations, which does not purport to be exhaustive, EU trade commissioner Peter Mandelson’s statement that the dispute between the two rivals will be the biggest, most difficult, and most expensive in the WTO’s history comes as no surprise. The protracted procedures at the WTO since October 2004 demonstrate the complexity of the case. This complexity and the difficulties in establishing proof make it appear unlikely at present that the WTO will issue a final ruling before the end of 2007.

Two reasons currently suggest that there will be no return to the negotiating table: Boeing’s recent success means that the U.S. side has a stronger market position at present. In this situation, it is presumably a great deal more difficult for the Europeans to make concessions since Airbus is experiencing a period of weakness. Finally, the discussion in Europe about temporary large government stakes in EADS and the unresolved financing of the A350 certainly do not increase the likelihood of a negotiated solution being reached in the short term. All in all, this transatlantic trade dispute is currently bogged down.

Hope for a Negotiated Settlement?

There are nevertheless a multitude of reasons for optimism about the resumption of bilateral negotiations—albeit at a later date. Both rivals must be aware that they could also end up as a (partial) loser in this dispute; the WTO could rule that the subsidies have to be repaid. At the very least, it is unlikely that there will be a clear winner, given the huge amounts of aid both sides have received; two Pyrrhic victories are more likely. The bottom line is that neither side can win this conflict outright.

In this regard, it is also questionable whether subsidies would really be reduced following a WTO ruling. Precedence in the history of civil aviation does raise doubts: in the dispute between Canada and Brazil about subsidies for the makers of regional jets, Bombardier and Embraer, both parties had their cases upheld. Little changed in the way subsidies were administered, however. Many market watchers consider this case to be too complex to be solved by the WTO once and for all. This means there is also great danger of harm being done to the WTO. Neither the United States nor the EU have any interest in such an outcome. Moreover, WTO decisions are always retrospective. They merely identify when a subsidy was prohibited and to how much it amounted.

It is also doubtful whether the world’s two biggest trading powers can afford such a dispute at the same time that new economic powers in Asia are forging ahead and turning up the heat in competition against the established national economies. Contrary to all the assertions that the subsidy dispute in the aircraft industry is separate from other transatlantic trading issues, it certainly weighs on bilateral economic relations.

Boeing and Airbus long ago ceased to be pure national champions. The international division of labor means that aircraft makers are purchasing an increasing share of components from suppliers based in their competitor’s country. WTO proceedings thus also damage the domestic industry indirectly. Furthermore, both companies have important clients on the opposite side of the Atlantic.

It should not be forgotten that the dispute costs money and ties up management resources which both companies would probably prefer to focus on projects for the future. Given that growth in air travel is set to continue into the future, there is sufficient sales potential for both manufacturers. If, by contrast, the sector were contracting and thus the battle were for share of a shrinking market, it would be more difficult to negotiate a settlement. After all, both sides of the dispute have, as noted, always stressed that they would prefer a negotiated solution. If they have not been merely paying lip-service to this objective, there is still a realistic chance of a solution being found outside the WTO.

Ways to Negotiate a Solution

There will have to be movement from both parties to enable negotiations to be resumed and amicable solutions to be reached. If one side were to set overly onerous preconditions, a negotiated solution would become impossible, as the other side would be rendered the loser from the outset. An acceptable solution is dependent upon both sides being able to save face. It is therefore worth considering starting new negotiations with a clean slate, i.e. all past accusations leveled at the other side should be set aside and the focus of negotiations should be directed towards the future.

The most important substantive objective of a solution reached outside of the WTO would have to be the lasting reduction of subsidies in the aircraft industry. The mistake made in the 1992 agreement of legitimizing subsidies must not be repeated. Certain transitional periods for the phasing-out of subsidies—which should not, however, be too long—ought to help with finding a consensus.

Since the aircraft industry is becoming increasingly international, the search for a lasting solution would be helped by the involvement of third countries that are important players in aircraft manufacturing. Difficulties in finding acceptable solu-

tions could arise with a larger number of negotiating parties, but a system of bilateral negotiations open to third countries could mitigate such complications.

Prevent a Subsidy Race

Regardless of whether or not a solution can be found outside of the WTO, the objective of politicians should be to prevent a subsidy race in the aircraft industry—especially given the invariably high margins in the sector (compared with those of airlines, for example). Since the cessation of all government assistance to the sector is unlikely, future subsidies should be restricted to basic research. It is, however, an illusion to believe that state influence in the aircraft industries of either the United States or the EU will decline in the near future, given the specific attributes of the market.

Author:

Eric Heymann, Deutsche Bank Research, Phone: +49 69 910-31730, E-mail: eric.heyman@db.com

Source:

Heymann, Eric. "Boeing v Airbus: The WTO dispute that neither can win," *Deutsche Bank Research* (February 2007).

Building Knowledge, Insights, and Networks for German-American Relations.

Located in Washington, D.C., the American Institute for Contemporary German Studies is an independent, non-profit public policy organization that works in Germany and the United States to address current and emerging policy challenges. Founded in 1983, the Institute is affiliated with The Johns Hopkins University. The Institute is governed by its own Board of Trustees, which includes prominent German and American leaders from the business, policy, and academic communities. Please visit our website at www.aicgs.org.

Boeing vs. Airbus: The WTO Dispute Neither Can Win

THE JOHNS HOPKINS UNIVERSITY
GERMAN STUDIES
FOR CONTEMPORARY
AMERICAN INSTITUTE

1755 Massachusetts Ave., NW
Suite 700
Washington, D.C. 20036 – USA
T: (+1-202) 332-9312
F: (+1-202) 265-9531
E: info@aicgs.org
www.aicgs.org

AICGS