

# **The Boeing-Airbus Conflict And American Policy On International Trade**

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## Introduction

International trade is the economic, political, and social glue that binds the nations of the modern world. It is the epitome of cross cultural interaction. The relationships it builds help bring prosperity and progress to many nations. These relationships also act as a deterrent to armed aggression, making international trade one of the most humane and efficient peace keeping tools that we have. However, international trade, like any tool, must be carefully monitored and attenuated to ensure fairness and promote ethical behavior amongst its participants. To accomplish this, the World Trade Organization (WTO) was created in 1995 to compliment the Global Agreement on Tariffs and Trade (GATT), a multilateral economic organization created after WWII. The WTO negotiates and formulates trade agreements between its 153 member nations, and enforces the stipulations that are agreed upon. Sometimes, disputes arise among nations, such as violations of treaty terms. When this happens, it is the job of the WTO to step in as an international court and mediate the situation. The WTO will often rule in favor of one or more nations or find guilty all nations involved in the case. The WTO then has the authority to punish nations at fault by granting the victim nation powers. Such powers include economic sanctions, such as import tariffs and other trade blockades that may be imposed on the guilty nation(s), and are protected under the laws of the WTO. The WTO also provides “technical assistance and training for developing countries” while cooperating “with other international organizations”.<sup>1</sup> The WTO helps keep global trade open and dynamic based on the rule of law.<sup>2</sup>

## Conflict

The United States and the Europe have been mutual partners in international trade since the American colonial period, and more formally since the creation of the European Union (EU) in 1993. Both have benefited greatly from each other, and trade continues to bolster their political and social relationship. However, to ensure the fair trade between the US and the EU, and the fair competition of product and service exports originating from both systems, agreements have been negotiated. In 1992, the US and the EU (then known as the European Economic Community), signed the bilateral EC-US Agreement on Large Civil Aircraft. A Large Civil Aircraft (LCA) is an aircraft with more than 100 passenger seats. The market for LCA is enormous, and worth an estimated \$3.7 trillion over the next twenty years.<sup>3</sup> This agreement was designed “to promote a more favourable environment for international trade in large civil aircraft and to reduce trade tensions in the area,” specifically involving Boeing and Airbus.<sup>4</sup> American-based Boeing had long run a monopoly over commercial aircraft sales. When French-based Airbus began growing rapidly in the late 1970s, the United States became concerned about its competitive potential. Specifically, the US worried about the amount of direct and indirect monetary support, or subsidy, that Airbus received to help build its early model aircraft. The

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<sup>1</sup> Jae Wan Chung. *The Political Economy Of International Trade*. pp. 72-73.

<sup>2</sup> “The World Trade Organization”. (viewed 11/9/2010)

<<http://www.ustr.gov/trade-agreements/wto-multilateral-affairs/-world-trade-organization>>

<sup>3</sup> Thompson, Loren. “Can Airbus Survive Without Subsidies?”. (viewed 11/7/10).

<http://blogs.forbes.com/beltway/2010/09/19/can-airbus-survive-without-subsidies/>

<sup>4</sup> “European Union Agreement On Large Civil Aircraft”. (viewed 11/10/10)

[http://tcc.export.gov/Trade\\_Agreements/All\\_Trade\\_Agreements/exp\\_002816.asp](http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/exp_002816.asp).

agreement placed a cap on how much subsidy the aircraft manufacturers could receive. In 2004, the US accused the EU of breaking that cap in support of Airbus, thereby placing Airbus in an unfair advantage over Boeing. The US accused the subsidies of being worth up to \$200 billion (139€ billion).<sup>5</sup> This violates the terms of the 1992 Agreement, and the complimentary Subsidy and Countervailing Measures Agreement of 1994 (SCM). In response, the EU almost immediately accused the US of issuing similar subsidies, worth up to \$23 billion, to Boeing. If both parties are guilty, they may perhaps move toward a negotiated settlement. However, if one is guiltier, they are subject to unilateral punishment under the victorious nation's remedy laws. In either case, the outcome will have significant impact on international trade.

## Terms of the Agreement

For the sake of simplicity, I will only outline the terms of the agreement that apply to the Boeing/Airbus case, as of 2004. The following terms are taken from the EC-US Agreement on Large Civil Aircraft. The SCM goes into greater detail as to what a subsidy is or is not, for example, but the noted alleged violations will only be analyzed in respect to the 1992 agreement.

**Article 3-** "As of entry into force of this Agreement, Parties shall not grant direct government support other than what has already been - firmly committed for the production of large civil aircraft. This prohibition shall apply both to existing and to future programmes".<sup>6</sup>

Basically, this prohibits the manufacturers from receiving government subsidies used for the production of aircraft.

**Article 4-** "4.1. Governments shall provide support for the development of a new large civil aircraft programme only where a critical project appraisal, based on conservative assumptions, has established that there is a reasonable expectation of recoupment, within 17 years from the date of first disbursement of such support, of all costs as defined in Article 6(2) of the Aircraft Agreement, including repayment of government supports on the terms and conditions specified below."<sup>7</sup>

Article 4 serves as the exception to Article 3. It allows subsidy for the production of *new* aircraft, up to 20% of total program cost, on the condition that the manufacturer pay back the subsidy plus interest.

**Article 5-** "Parties shall take such action as is necessary to ensure that indirect government support neither confers unfair advantage upon manufacturers of large civil aircraft benefiting from such support nor leads to distortions in international trade in large civil aircraft."<sup>8</sup>

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<sup>5</sup> "Boeing, Airbus Claim Victory Over WTO Ruling". (viewed 11/9/10).  
<http://www.eubusiness.com/news-eu/wto-trade-dispute.3sp>.

<sup>6</sup> "European Union Agreement On Large Civil Aircraft".

<sup>7</sup> *Ibid.*

<sup>8</sup> *Ibid.*

This simply means that the indirect support should not disrupt the current balance of trade. It goes on to describe indirect support as government-funded research that results in production benefits. For example, research that allows the manufacturer to build a cheaper, more efficient aircraft engine would be considered indirect support.

**Article 8** is the longest of the articles, and vaguely titled “Transparency”. Essentially, both parties must make every effort, not to include risk to their own security, to “exchange on a regular, systematic basis, all public information” relating to their received government subsidy.<sup>9</sup>

## **Alleged Violations and WTO analysis**

The US officially filed its complaint to the WTO on 6 October, 2010. The US accused the EU, specifically four of its member nations—France, Germany, Spain, and the United Kingdom—of 300 separate instances of subsidization over nearly forty years.<sup>10</sup> These will be grouped into the five categories that the WTO panel chose. The US accused the following:

- i. The EU financing the design and development of Airbus companies, otherwise known as “launch aid”.<sup>11</sup> Launch aid is designed to help an infant company get going, and is to be repaid plus interest under Article 4 of the 1992 Agreement on LCA. The panel only found prohibited export subsidies for the Airbus A380.<sup>12</sup>
- ii. Airbus taking loans from the European Investment Bank. The panel found the loans to be subsidies, but dismissed them as the US did not specify the various subsidies.<sup>13</sup>
- iii. Airbus receiving infrastructure grants. The panel found that certain provisions, such as the financing of runway extension at the Bremen airport, to be subsidies.
- iv. Airbus receiving corporate restructuring measures.<sup>14</sup> The corporate restructuring measures in this case refer to a questionable German investment in Deutsche Airbus in 1992. The panel found this investment as a subsidy, as the investment was “inconsistent with the usual investment practice of private investors”.<sup>15</sup>
- v. Airbus receiving research and technical development funding. This falls under Article 5 as indirect support. The panel found most of these grants to be subsidies.<sup>16</sup>

## **WTO Ruling**

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<sup>9</sup> Ibid.

<sup>10</sup> “Measures Affecting Trade In Large Civil Aircraft”. (viewed 11/10/10).

[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds316\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds316_e.htm).

<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

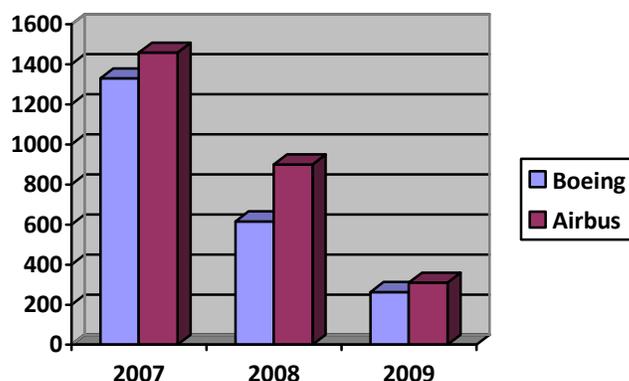
<sup>13</sup> Ibid.

<sup>14</sup> Ibid.

<sup>15</sup> Ibid.

<sup>16</sup> Ibid.

Deborah Mesloh, Deputy Assistant to the United States Trade Representative, says “The United States has always maintained that the European governments have provided unfair subsidies to Airbus that harm U.S. interests”.<sup>17</sup> The panel then decided whether these subsidies actually harmed US interests. The harming of competitors’ interests primarily refers to the unfair advantage that subsidies give a manufacturer. The subsidy potentially lowers production costs or provides resources to produce superior products. In either case, those advantages allow the manufacturer to use aggressive pricing on exports that other competitors cannot match. Other competitors, in this case Boeing, tend to lose sales. This disrupts the natural flow of international trade. The WTO decided that the “United States had demonstrated the existence of displacement of imports and exports from the European and certain third country markets, as well as significant price depression, price suppression and lost sales, but had failed to demonstrate the existence of significant price undercutting.”<sup>18</sup> The panel also concluded that with those aforementioned subsidies, Airbus would “not have been able to launch and develop the LCA models it actually succeeded in bringing to the market.”<sup>19</sup> Figure 1 shows the net orders for aircraft as reported by Boeing and Airbus over the last three years.<sup>20 21</sup>



**Figure 1**

Although the chart shows a steady decline in aircraft orders on the whole (this can be attributed to the economic recessions in recent years), Airbus clearly dominates over Boeing. Airbus first

<sup>17</sup> Raum, Tom and Borak, Donna. “WTO Ruling Gives Boeing Co., Victory Over Airbus”. (viewed 11/9/10).

<http://www.allbusiness.com/government/government-bodies-offices-legislative/12839769-1.html>.

<sup>18</sup> “Measures Affecting Trade In Large Civil Aircraft”.

<sup>19</sup> *Ibid.*

<sup>20</sup> “Orders and Deliveries”. (viewed 11/11/10).

<http://active.boeing.com/commercial/orders/index.cfm?content=displaystandardreport.cfm&RequestTimeout=500&optReportType=AnnOrd&pageid=m15521>.

<sup>21</sup> “Orders and Deliveries”. (viewed 11/11/10).

[http://www.airbus.com/en/corporate/orders\\_and\\_deliveries](http://www.airbus.com/en/corporate/orders_and_deliveries).

defeated Boeing in orders and deliveries in 2007, and has since consistently taken more orders than Boeing. This threat to Boeing is what the US has long feared. The WTO panel's decision suggests that Airbus would not have been able to produce these aircraft without the subsidies and thus would not have overtaken Boeing in orders and deliveries. Further, the panel found that because of these subsidies, the US suffered significant loss in sales to the markets of third party countries, such as India, China, Australia, and Brazil.<sup>22</sup> These affects "constituted serious prejudice against the interests of the United States".<sup>23</sup>

Overall, the WTO rulings display a clear victory for the US. However, the ruling is currently under appeal. Additionally, the EU brought its own accusations against the US, claiming that Boeing had received prohibited and actionable subsidies from State (infrastructure) and Federal Government (tax breaks, Department of Defense contracts and NASA research) worth up to \$23 billion. The WTO found those subsidies only to be worth a few billion, pocket change for Boeing. Defense Industry Consultant Loren Thompson describes the two decisions in the analogy, "the Sept. 15 ruling amounted to a slap on the hand for Boeing...But the earlier ruling against Airbus was more like having its hand cut off".<sup>24</sup>

## US Options

When a foreign nation violates terms of a treaty, and the United States Trade Representative (USTR) finds the violation harmful to the US, he is *required* under the power of the President to prosecute the violator and unilaterally enforce US trade rights.<sup>25</sup> The US can enforce its trade rights with trade remedy laws. The primary trade remedy policy tools are countervailing duty (CVD) and antidumping duty.<sup>26</sup> However, as this case refers to subsidies, only CVD would apply. The US can order CVD, essentially tariffs, against imported merchandise as punishment. However, the merchandise is not simply limited to Airbus products. Instead, the US can impose import tariffs on any variety of products from the EU, and these products are not limited to products from the nations at fault (France, Germany, etc.), but can come from any EU member. For instance, the US can tax imports on Italian leather, French wines, Swiss dairy products, or German automobiles. The goal behind these tariffs is to punish the treaty violator to deter from future infractions while remedying the harm done to the US economy.

Additionally, the WTO panel recommended that the EU immediately withdraw all subsidies to Airbus, within 90 days. Under US trade law, the EU could be forced to make a cash deposit or post a bond equal to the estimated export subsidies.<sup>27</sup> However, as the WTO dismissed many of the allegations against the EU, the estimated subsidies, though still confidential, are likely to be much less than the original estimate of \$200 billion. Nevertheless,

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<sup>22</sup> Measures Affecting Trade In Large Civil Aircraft".

<sup>23</sup> *Ibid.*

<sup>24</sup> Thompson, Loren. "Can Airbus Survive Without Subsidies?"

<sup>25</sup> Jae Wan Chung. *The Political Economy Of International Trade*. p. 123

<sup>26</sup> *Ibid.*, p. 47

<sup>27</sup> *Ibid.*, p. 53

one can assume that the new estimate will likely exceed \$75 billion. Either way, Airbus will likely be forced to surrender its subsidies.

On the other hand, the US could move toward a bilateral negotiated settlement with the EU, which the EU would now enthusiastically prefer.

## **Policy Recommendations**

The US should not move for a negotiated settlement. If the EU wanted a settlement, they should have asked for it before the WTO's rulings. They took a risk, and they lost. Because the WTO ruled in favor of the US, the US has no reason now to negotiate with the EU. The US needs to stand up for itself and stick it to the EU. CVD should be imposed. Imports on high dollar items such as automobiles and technology should be heavily taxed, and the EU should have to post bond to account for the subsidies given to Airbus and remedy damages done to the US economy. This will put the most hurt on the EU, and the nations, whether involved with the unfair subsidies or not, will hopefully defer from such action in the future. Will their feelings be hurt? Will they harbor anger against the US? Of course, however these consequences are small in comparison to the consequences of negotiating a settlement.

## **Conclusion**

Airbus has orders well into the future placed by foreign countries who are also Boeing customers. To allow them to fulfill those orders with the help of unfair subsidies provided by the EU would continue to hurt Boeing and our economy, and is a direct attack from other nations on US interests. Unquestionably, trade contributes greatly to the US economy. From the time period of 1992-1999, the USTR reported that trade gave rise to \$2.1 trillion (28.6%) in economic growth, 21 million jobs (lowering unemployment by 4.0%), and a 40.5% increase in industrial growth.<sup>28</sup> Additionally, Airbus is competing with Boeing for a \$35 billion US Air Force contract to build new aerial refuelers. Continued use of subsidy will allow Airbus to finance the bid for this contract, essentially undercutting Boeing.<sup>29</sup> The undercutting of companies such as Boeing is an important issue when analyzing why the US continues to import more than it exports. Exporting becomes frustrating when foreign countries can buy goods at artificially low prices due to subsidy that US companies cannot match. This creates a trade deficit, which continues to hurt our economy. However, the US trade remedy policy will do much more than simply serve the interests of the US economy. If the US moves for a settlement, it is condoning the actions of the EU. If the EU gets away without deserved punishment, what example does that provide to other nations who may be contemplating cheating the system of international trade? The outcome would only lead to further distortions of the international market. The US must enforce its rights under the trade treaties and WTO to prevent further damages to itself and other nations, or the future of international trade is doomed.

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<sup>28</sup> Jae Wan Chung. *The Political Economy Of International Trade*. p. 182

<sup>29</sup> Raum, Tom and Borak, Donna. "WTO Ruling Gives Boeing Co., Victory Over Airbus".

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