



## Airbus and Boeing

Author John Newhouse summarizes the history of the large commercial aircraft (LCA) industry in a few sentences:

An existential pendulum governs the fortunes of the companies that struggle to gain an edge in this unsteady business. At one time, the advantage might have drifted now to Douglas, now to Lockheed, now to Boeing. Then, in the years between 1985 and 2005, the gestalt changed. As the weaker players fell away, the focus shifted to a hardier but dissimilar pair: mighty Boeing and the arriviste Airbus.

For much of that time, Boeing held a commanding lead, its supremacy not really contested. Nevertheless, by the mid-1990s, if not before, the gallery could see this twosome's fortunes start to converge.<sup>1</sup>

Exhibit 1 depicts Airbus and Boeing's orders and deliveries since 1990. By 1990, Airbus was already a serious contender in terms of orders if not in terms of deliveries.

### The 1992 agreement

Although Boeing's loss of dominance was largely self-inflicted ("Boeing, complacent and risk averse, became less committed to the fundamentals of its trade"<sup>1</sup>), the North-American company continually and increasingly protested over government support to its new main competitor. Since the beginning of Airbus in 1970, the company has benefited from so-called launch aid, development loans by the European governments — France, Germany, Spain and the U.K. — with an share in Airbus (or EADS, its current parent). Not that Boeing is free of government help, only that it takes place through different channels: corporate tax breaks, cross-subsidies from military sales, indirect support through key Japanese suppliers, and more.

In 1992, the US and the EU attempted a truce in the subsidy war. Airbus agreed to limit government support to one third of development costs; it also agreed that reimbursable loan investments (the formal name of the launch aid received by Airbus) be fully repaid within 17 years, and that the interest rate be at least equal to the cost of government borrowing plus 0.25%.<sup>2</sup> Boeing, in turn, pledged to limit indirect aid through Department of Defence and NASA development contracts to 4% of the company's civil-aircraft turnover.<sup>3</sup>

All this took place during the last months of the Bush administration. Soon after, recently elected President Clinton spoke in Seattle to a group on Boeing workers. Boeing had recently announced a massive number of layoffs.

I think you and I know, deep in our hearts, that most of these layoffs ... would not have been announced had in not been for the \$26 billion that the United

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Written by Professor Luís Cabral for the purpose of class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. © 2009 Luís Cabral.

States sat by and let Europe plow into Airbus over the last several years. So we're going to try to change the rules of the game.<sup>1</sup>

For all his bravado, in eight years of presidency Clinton and the US did little to rock the unstable equilibrium ensuing from the 1992 agreement.

## The WTO dispute

Then, in 2004, things began to change. In July, US trade representative Robert Zoellick called for the renegotiation or even abolition of the agreement:

If there was ever justification in 1992 or earlier for a start-up industry, that has long been overcome.<sup>4</sup>

To this, President Bush added the threat of WTO litigation:

I've instructed the US trade representative Bob Zoellick to inform European officials that we think these subsidies are unfair and he should pursue all options to end these subsidies, including bringing a WTO case if need be.<sup>5</sup>

In October, the United States filed an initial suit against Europe at the WTO.

On January 12, 2005, Mr. Zoellick and his European Union counterpart, Peter Mandelson, reached a truce and agreed to solve their differences outside the WTO.<sup>6</sup> "This case should never have gone this far, since both sides receive government subsidies, but differently," said industry analyst John Newhouse.<sup>7</sup>

But then on January 12, Noël Forgeard, Airbus' CEO, announced the company was applying for launch aid totalling about \$1.3bn to help finance the estimated \$5.2bn development cost of its planned A350 long-range airliner.<sup>8</sup> The Airbus announcement didn't bode well for the US-EU truce. Former undersecretary of commerce for international trade Jeffrey Garten feared that

The recent breakdown of the 1992 agreement ... could very soon be referred to the World Trade Organisation for adjudication ... Should a case be filed, transatlantic relations will be further poisoned, just when there is a critical need for co-operation on Iraq, Iran and other explosive political issues.<sup>9</sup>

Regarding the case, his prediction was that

The judicial outcome is already clear: both aerospace companies have taken considerable government handouts. The court will declare both guilty, creating a political stalemate in which both sides will probably ignore the penalties the WTO wants to impose.<sup>9</sup>

In the next few weeks, the parties tried to maintain their fragile truce. Phone calls were exchanged. But the patience level was declining rapidly. Public statements from each side of the Atlantic were less than conciliatory. One European official linked Boeing's flare-up to Airbus's commercial performance: "Airbus has successfully launched a new model, and Airbus is now the Number One when it comes both to new orders and deliveries. Boeing is simply getting nervous."<sup>4</sup> Boeing's CEO Harry Stonecipher illustrated Airbus' lack of

market discipline by declaring, “I think the A380 is the dumbest thing anyone has ever done.”<sup>1</sup>

Matters got even worse on April 1st, when Mandelson himself went public with an op ed piece published in the *Washington Post*. Mandelson makes several points. First, that government subsidies are a reality on both sides of the Atlantic

The EU ... believes that the United States gives far greater support to Boeing than is given to Airbus.<sup>10</sup>

Second, Mandelson asked for a process of mutual and simultaneous concessions by Airbus and Boeing:

We cannot be expected to trade off our entire investment plan for Airbus up front in a first step without substantive US offers ... The United States argues that such commitments can be made only in a second stage ... Both sides need to take a balanced, step-by-step approach ... This is the rational way forward. Litigating in the World Trade Organization ... would fail to achieve the ... objectives of either the US trade representative or Boeing.<sup>10</sup>

Finally, he left it clear how the EU would react if the US were to initiate a WTO complaint.

The EU is not threatening to take the United States to court, but it would have no choice but to launch a counter-case if Washington pulled the WTO trigger.<sup>10</sup>

In late May, the US filed a complaint with the World Trade Organization. Immediately after, the EU filed its own counter complaint. The North-Americans accused Airbus of receiving subsidies worth \$17 billion in launch loans over the preceding 35 years. The Europeans countered that Boeing had enjoyed R&D subsidies worth \$23 billion in the preceding 13 years.<sup>3</sup> On July 20, the WTO officially opened its enquiry. The 148 member countries agreed to form two panels — one for each complaint — composed on non-EU and non-US members.<sup>11</sup>

## **Facts, estimates, and opinions**

Government support to Airbus consists primarily of reimbursable loan investments, also referred to as launch aid. These are loans by the governments of France, Germany, Spain and the U.K. to help Airbus cover part of the development expenses with each new aircraft. Boeing claims the cumulative benefit of launch aid over two decades exceeds \$100bn. Moreover, Boeing claims, if one includes other handouts such as funding for roads and runways, then the combined value of all the subsidies is \$205 billion.

Airbus counters that, since 1992, it has paid governments 40% more than it has received from them: launch aid is a reimbursable loan (though it is forgiven if the program does not succeed).<sup>12</sup> In Peter Mandelson’s words, “It’s a win-win arrangement: Airbus pays the nations back as it is able to sell its planes, and over time the governments concerned have made a handsome profit.”<sup>10</sup>

The European Union’s case against Boeing is that the US manufacturer receives an array of of subsidies from different American agencies, from NASA to the Export-Import Bank of the United States (also known as “Boeing’s Bank”), as well as tax breaks at the state and federal level. Europe’s estimate of Boeing’s overall benefit is near \$305 billion.<sup>12</sup>

Keeping tabs on the most recent wave of government support (the B787 and the A380), industry analyst Stanley Holmes claims that the score favors Boeing:

Boeing’s \$3.2 billion tax break hardly compares to the \$6 billion in benefits and tax goodies the Europeans have heaped on their A380 mega jetliner.<sup>13</sup>

But Airbus estimates that up to \$7 billion-worth of government aid was given to the 787 program.<sup>12</sup>

Clearly, there is disagreement over the values of government support on either side. Moreover, the nature of government support is very different in the US and the EU. Peter Mandelson claims that US subsidies cause more distortion than the European system of launch aid: “In contrast to the EU’s investment in Airbus, *none* of [Boeing’s] subsidies need to be repaid.”<sup>10</sup> Industry analyst Stanley Holmes argues the opposite is true: “Boeing shoulders all of the development and investment risk upfront. Launch aid, by contrast, shifts risk away from the market.”<sup>13</sup> *The Economist* points to another difference between the two systems:

Boeing is right to argue that all subsidies distort competition. But although the subsidies that Airbus receives are different from Boeing’s, they are not necessarily much worse. At least they are transparent.

## **Why worry about subsidies?**

Industry analyst John Newhouse thinks the focus of attention may be too centered on subsidies:

The divergent fortunes of Airbus and Boeing since the 1980s had far less to do with government support than with how the two companies competed in an unforgiving business ... Boeing should have focused less on failure than on building the new products that would have responded most effectively to trends in the marketplace.<sup>1</sup>

*The Economist*, in turn, argues that subsidies are probably not that anti-competitive:

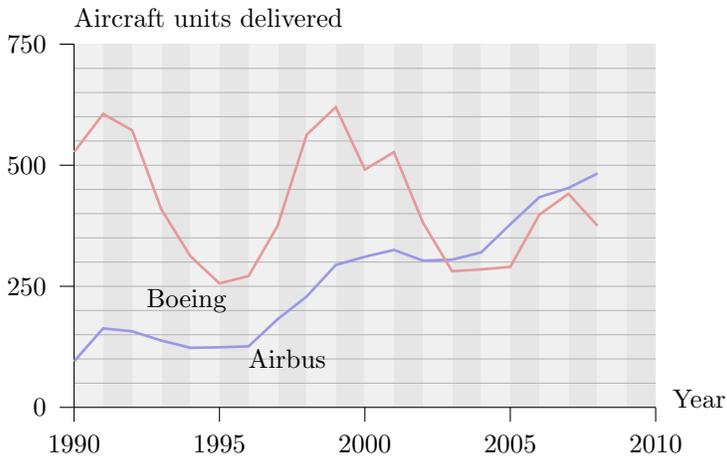
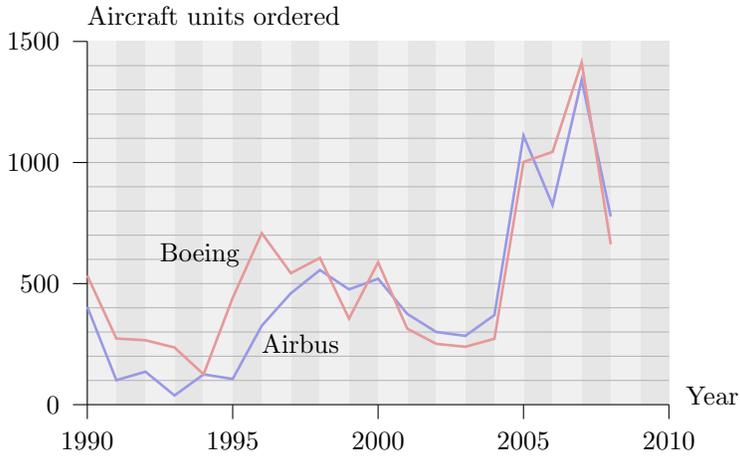
Boeing and Airbus fight like rats in a sack for every sale, with the consequence that airlines have been able to buy cheaper and better aircraft than if one firm had been dominant.<sup>14</sup>

## **Update**

The panels set by the WTO in July 2005 were expected to issue a ruling in 18 months.<sup>11</sup> Four years later, no ruling had yet taken place. As of August 2009, a decision on the US complaint was expected to arrive soon, followed by one on the EU complaint.<sup>14</sup>

**Exhibit 1**

Large commercial aircraft orders and deliveries. Source: See Endnote 15.



## Endnotes

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3. "Nose to nose — Boeing v Airbus; Boeing v Airbus," *The Economist*, June 25, 2005.
4. Buck, Tobias, "US-EU aircraft subsidy dispute fizzles out," *Financial Times*, July 22, 2004.
5. Buck, Tobias, "Bush fuels US-EU aircraft subsidies dispute," *Financial Times*, August 15 2004.
6. US, EU Resolve to Settle Dispute," *Seattle Times*, January 12, 2005.
7. Elizabeth Becker and Paul Meller, "Boeing-Airbus aid dispute is taken outside the WTO," *New York Times*, January 13, 2005.
8. Done, Kevin, and Peter Spiegel, "Airbus asks European states for A350 aid," *Financial Times*, January 13 2005.
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12. "Boeing and Airbus argue about subsidies," *The Economist*, August 13, 2009.
13. Holmes, Stanley, "Boeing vs. Airbus: Time to Escalate," *Business Week*, March 21, 2005.
14. "A dogfight no one can win," *The Economist*, Aug 13, 2009.
15. [http://www.airbus.com/en/corporate/orders\\_and\\_deliveries/](http://www.airbus.com/en/corporate/orders_and_deliveries/); and <http://active.boeing.com/commercial/orders/index.cfm?content=displaystandardreport.cfm&optReportType=CurYrDelv>.