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The Boeing-Airbus “Can of Stink”

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The Boeing-Airbus “Can of Stink”

Fernando Alvarez-Pérez*

The European Union and the United States have the largest trading relationship in the world, comprising about 60% of world trade (Perdikis and Read 267). They are also the greatest proponents of trade liberalization and multilateral trade cooperating in the world. Boeing was the undisputed king of aircraft manufacturing for most of the 20th century. Airbus has been encroaching upon that position since the 1970s. In 2000, Airbus dethroned Boeing in terms of sales, and the two have been in a bitter battle since. A subsidy dispute currently underway between Boeing (supported by the US) and Airbus (supported by the EU – mostly from Germany, England, France and Spain) could have devastating consequences upon that relationship and their credibility in promoting neoliberal values abroad. Most trade disputes are solved through consultation, without the need for a ruling by the World Trade Organization. Unlike most others, dispute regarding aircraft has elicited a special and unprecedented aggression on the part of these two trading partners.

This dispute is not new; only the current incarnation of the dispute is new. Aircraft were not covered by the original 1947 GATT agreement, but was finally included in 1979, when the US and the European Communities signed the Agreement on Trade in Civil Aircraft. The agreement was a response to the fact that the US was putting a 6% tariff on the puny European competition. Americans were angry about the level of state subsidies to Airbus (a sentiment which continues to the present) and the pressure that Europeans were putting on their airlines to buy European planes (Lynn 176-177). The agreement was largely symbolic, as the Committee on Trade in Civil Aircraft that it created refused to exercise what little power it had. Still, the agreement did serve as the basis for the first serious escalation of tensions.

It is important to note that these sides do not attack each other simply once one side does something the other considers unfair. The two sides have both been practicing what the other side considers unfair since before the first 1979 agreement. Boeing (from the 1980s on being the complainant in each case) decides to act within the framework of the GATT (and later the WTO) whenever it feels threatened by Airbus. In the early 1980s, with the windfall profits generated by Reagan’s massive defense spending, Boeing had little concern for Airbus. In the late 1980s though, Airbus began to penetrate US and Asian airline markets, and Boeing was nearly dismantled in a corporate raid involving Texan T. Boone Pickens (185).

Thus, in 1986 the US brought its dispute to the GATT, claiming that Airbus’ state subsidies were a violation of the 1979 agreement (Piening 107). The arguments put forth in this case can be considered a template for the dispute that continues to this day. The US charged the EC with giving Airbus massive subsidies. The US paid for research to be carried out on the nature of Airbus’ relation to EC member states, finding that the investments these governments made in Airbus were not made with a reasonable expectation of commercial return, a form of dumping (Lynn 189). As was then and still is today, Airbus’ subsidies were far more obvious than Boeing’s. The EC claimed that Boeing’s massive defense contracts, tax breaks and research and

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development “cost-sharing” programs were not repaid, as Airbus’ loans ostensibly required. The US began considering using Section 301 of the 1974 Trade Act to place tariffs on certain EC goods across the board (such as BMWs and Volkswagens, a much scarier prospect for the EC than airplanes) (Piening). None of this mattered, as Boeing was not ready for a trade war. As Lynn notes, a trade war for the much larger Boeing would be a Pyrrhic victory at best, and at worst, its downfall.

In April 1992, the US Trade Representative and the European Commission agreed to a Bilateral Agreement on Trade in Large Civil Aircraft. Among other things, it limited direct subsidies to about a third of development costs; indirect subsidies were limited to about 5% of revenues (Lynn 201). Each side was allowed to temporarily suspend the agreement, a prerogative that the US would interpret very liberally later on.

Since the agreement was signed, US elites have been consistently hostile towards the agreement, beginning with the 1992 presidential race. It became a populist theme in the 1992 election race, with candidates denouncing European protectionism and portraying it as an enemy of the American laborer. After becoming president, Bill Clinton visited a Boeing factory in Seattle, blaming the recent worker layoffs on European protectionism (Newhouse 48). Clinton wanted to revoke the agreement and counter European subsidies with new direct American subsidies. Boeing executives, however, were far less cavalier. It still retained the dominant market position and was not eager for a trade war (49). Of course, once Airbus dethroned Boeing, they were itching for it.

The 1992 agreement tranquilized both sides, at least with respect to airplanes. General trade policy was still contentious. Since the 1970s, the US had been offering tax benefits on exports for US products through the 1971 Revenue Act, ostensibly for the purpose of avoiding double taxation for US firms operating abroad (Rhodes 178-179). Most countries do provide a tax break to domestic companies with overseas subsidiaries, because the income from those subsidiaries would be taxed in both the host and home country. The US was offering tax breaks to companies operating in the US and exporting to other countries (foreign sales corporations, or FSCs), an obvious export subsidy. The EU, to little avail, brought the measure to the GATT in 1976. Little changed until the WTO, with its more robust dispute settlement procedures, began operating. In 1996 the EU revived the case, and in 1999 the WTO ruled against the FSC tax benefits the US was supplying (180). The US equivocated and replaced the FSC provisions with a nearly identical Extraterritorial Income (ETI) Act in November 2000, and immediately the EU brought the newly polished subsidies to the WTO again. This time, though, the EU sought countermeasures. The WTO ruled against the US again. In 2001, the WTO authorized the EU to impose tariff countermeasures up to \$4 billion against the US. This was by far the largest countermeasure ever approved. The EU had little intention of applying such harsh and destructive sanctions, considering the enormous harm they could do to fruitful transatlantic trade relations. The loss of this initial hesitance would underline the severity of the rancorous aircraft dispute. It would seem to be almost reckless that the EU would wish to awaken the sleeping subsidy dispute, but that is exactly what it did in April of 2004. Regulation (EC) 868/2004 authorized “redressive measures” against external air carriers benefiting from subsidies and “unfair pricing practices” (EUR-Lex). It was fairly obvious that this regulation was aimed directly at Boeing, for the protection of Airbus.

On October 6, 2004 the US filed dispute DS 316 with the WTO, regarding trade in Large Civil Aircraft. Specifically, the US charged the EU with violating the Subsidies and Countervailing Measures Agreement of GATT 1994, of which specifies which types of government aid are subsidies, and also the types of “countervailing measures” – sanctions – that can be imposed upon the offending country. It also charged the EU with violating Article XVI: 1 (on subsidies) of GATT 1994 (WTO, “DS316”). On the same day, the US unilaterally withdrew from the 1992 Bilateral Agreement on Trade in Large Civil Aircraft. It is impossible to know exactly what motivated the US to bring the dispute back to the WTO, but the EU’s Regulation

868/2004 was both a clear indication of its willingness to do battle over the issue. The most obvious strategic reason for filing the complaint was Boeing's dethroning as king of the LCA. According the US Trade Representative at the time (and now current president of the World Bank) Robert Zoellick, "Europeans have justified subsidies to Airbus as necessary to support an 'infant' industry. If that rationalization were ever valid, its time has long passed. Airbus now sells more large civil aircraft than Boeing," (qtd. in USTR, "US Files WTO Case"). Basically, Zoellick was saying that Airbus no longer needed subsidies, so why should it still get them? Previously, Boeing had been hesitant to bring action to the WTO because of the potential increased protectionism and prices around the world that could result from a WTO dispute. Now, it no longer had the most to lose, having been replaced by Airbus as the dominant LCA manufacturer. In the same press release that announced the filing, the USTR explained its withdrawal from the 1992 agreement. The USTR held that because the 1992 agreement was negotiated when Airbus had only about a third of the LCA market, it was no longer relevant in 2004, where Airbus had the majority of the LCA market. Not only does Boeing have less to lose, litigation would be an effective measure to stall the launch of new planes. Lewis Platt, Boeing's non-executive chairman, said in 2005 "It should not be easy for them to launch the A350 program, as they're choking on trying to finish the A380" (qtd. in Greising). The delays on the A380 and the attempted launch of the A350 attest to the power of this strategy.

Another explanation for the United States' actions proposes that the cancellation of the 1992 agreement was neither a simple reaction to changes in market positions nor an attempt to lash out at the new LCA alpha male. It was more than that; Pritchard and MacPherson (probably the most important scholars on the topic) hold that the severance of the agreement was a calculated and rational move on the part of Boeing and placed them into the most favorable legal and competitive position. Their explanation involves the legal justification of Airbus' subsidies and the strategic/financial position that the cancellation put the two companies in. In April of 2004, after analyzing the method that Boeing would use to develop and produce the 787 "Dreamliner," they explained that the proposed plan for producing the 787 would have been in violation of the 1992 agreement ("Industrial Subsidies" 62). Being a bilateral agreement and non-WTO agreement, the cancellation of the agreement would not affect its position in a WTO dispute. Zoellick echoed this separation between bilateral agreements and WTO law in the previously mentioned press release. An added advantage was that by withdrawing from the 1992 agreement, it nullified the only legal justification that Airbus had for its subsidies ("Strategic Destruction" 5). At the same time, Boeing was moving its government support into other more legally tenable and less obvious forms.

With regards to the strategic/financial position that the cancellation put the two companies in, it forced Airbus to become what industrial scholars refer to as "systems integrators," which Boeing already was. Since the 1970s Boeing has gradually been moving the production of the major parts of its planes overseas (such as the 787's composite wings made in Japan). A number of systems (such as electrical components, the engines and the wings) were made around the world, and Boeing's job has moved from manufacturing and integrating those systems to simply integrating them (2). In the short term, this spreads the enormous financial risk of "launching" (developing, producing and selling) a new commercial aircraft model across many partners ("Industrial Subsidies" 59). In return, the suppliers abroad are granted a share of the project's revenues and access to valuable technology (absolutely essential for Japan's ambitions to enter the commercial aircraft market). This means that Boeing has to rely less on *direct* (and therefore legally vulnerable) government support or more importantly its own cash reserves when it wants to make a new plane. 90% of the 787's inputs will be built in other countries, by other companies; Boeing workers for the most part only combine these parts in the factory, a 3-day process. With the cancellation of the 1992 agreement, Airbus would no longer have a legitimate source of government funding, so it would have to become a systems integrator to provide for the cost of its new projects ("Strategic Destruction" 5). In February of 2007, Airbus announced a

restructuring program known as Power8, a euphemistic name for systems integration (Airbus Press Centre). Boeing's move was a shrewd one, indeed.

On the same day that the US filed DS316, the EU filed DS317 (WTO, "DS317"). Just like DS316, it was a complaint about aircraft subsidies, though it alleged wrongdoing on different grounds. Like the US complaint, it alleged a violation of provisions of the SCM Agreement. However, it charged the US with violating Article III:4 of GATT 1994, which pertains to favorable taxation practices (Europa March 2007). In January of 2005, Peter Mandelson – the successor to Pascal Lamy as EU Commissioner for External Trade – and Robert Zoellick agreed to hold off litigation for three months as they tried to reach a most lofty agreement to end aircraft subsidies (Europa, "EU/US Agreement"). The critical issue in these negotiations was the financing of the upcoming Boeing 787 and Airbus A350 (Newhouse 59). Zoellick and Mandelson clashed throughout the negotiations, and it was dead in the water by April, when Mandelson published an op-ed piece in the *Washington Post* that was highly critical of Boeing's subsidies. In May of 2005, the US filed another complaint with the WTO regarding Airbus subsidies, and the EU responded in kind with their own complaint, DS353 (Newhouse 60). The US dropped the complaint, but the EU continued with DS353 (officially filing its complaint on June 27th). On January 1st, 2006, the US filed a new request for consultation – DS347 – to "reflect the fact that EU member states have announced new subsidies in the time since the United States filed its initial consultation request" (USTR, "United States Files Additional Consultation"). Thus, by February of 2006, the EU and US were no longer in a legal battle; they were in a full-blown legal war, fought on four different fronts.

So where are they now? To answer that question, one must first understand the WTO dispute settlement system. The Dispute Settlement Understanding was Annex 2 of the GATT 1994 Agreements (Read 29). It provided for a far more powerful dispute settling mechanism than the GATT methods, the weakness of which helps to explain the continuing defiance of the previous GATT agreements by both the US and EU in this dispute. When there is a trade dispute, a country requests consultation with the WTO. The two parties attempt to negotiate the dispute and come up with a solution. If consultations fail, the complainant requests a Panel of experts to be appointed by the Dispute Settlement Body. The Panel consults with the parties as it creates a report which is to be delivered and circulated generally within six months. Unless a unanimous vote by the members of the DSB rejects the Panel's report, the report becomes a ruling (WTO, "Understanding"). After that there is a multitude of procedures to ensure compliance, but those are not relevant to this topic because currently the talks are stalled at the Panel stage. Because of the amount of simultaneous disputes on the same topic, the Panels for all but DS347 have informed the DSB that they will require an extra year to complete their report (WTO, "List"). The US has agreed to suspend DS347 until after the DS316 Panel report because of the procedural complexities of the number of cases ("General Overview" 27).

"If you're going to open the can of stink on one side of the industry, it exposes the rest of the industry...that's not good for anybody."

-Allan McArtor, chairman of Airbus North America¹

"The judicial outcome is already clear: both aerospace companies have taken considerable government handouts. The court will declare both guilty, creating a political stalemate,"

-Jeffrey Garten, formerly undersecretary of international trade for Bill Clinton and currently the dean of the Yale School of Management²

¹ quoted in Greising

² quoted in Garten

These two statements perfectly express the utter quagmire that Boeing and Airbus have become entangled in. It may seem that the fate of these two companies will be determined by the ruling the WTO will impose, but it isn't. Both sides will be found guilty. Boeing will benefit in the short term from this situation, but both Boeing and Airbus will suffer immeasurably in the long term. First, it is important to understand why both will be found guilty.

Boeing is guilty of violating every provision of the SCM Agreement and GATT 1994 that they are accusing Airbus of violating, and vice-versa. Boeing has received \$3.2 billion in tax cuts from the State of Washington, which are repaid based on the number of planes sold (Washington Research Council). This is sufficient to qualify the tax break as a Prohibited Subsidy by WTO laws³. A 2005 article in the Chicago Tribune details the subsidies uncovered by a team of Boeing lawyers sent to Europe on a fact-finding mission. One item they found was an \$850 million project to fill in part of the River Elbe to facilitate the building of a production facility there. The SCM agreement considers such infrastructure projects illegal⁴. The aid to the production of Boeing's 787 matches each of the three possible definitions of a *specific* (a necessary condition for an subsidy to be considered illegal) subsidy as outlined in Article 2.1 of the SCM Agreement (Pritchard and MacPherson, "Industrial Subsidies" 63). Airbus charged Boeing with receiving extravagant benefits from NASA and the Department of Defense research and development collaboration projects. On the other hand, the EU has set aside a \$1 billion budget for aerospace research, from which Airbus' parent company – EADS – directly benefits (Greising). The details of the WTO-incompatible transgressions US and EU have committed in funding these companies would require a multi-volume work. Either way, both sides are in the wrong.

Still, Boeing will gain a substantial benefit from this conflict in the short-term. Airbus posted a loss in 2006, and Boeing defeated it in revenues for the first time since 2001 (Gates). Boeing certainly is "choking" on the A380 as a result of this litigation. The Power8 restructuring of Airbus shows that Boeing has been successful at forcing Airbus to become systems integrators. Still, in the long-run, this will be a loss for both sides.

If both sides are found guilty, then the WTO will no longer be a legitimate dispute settlement actor in this case. Boeing, the US, Airbus and the EU will then be left to their own devices to fight the Boeing-Airbus competition. That means increased protectionism, resulting in higher prices for consumers and the disappearance of foreign market opportunities; it would also precipitate a general icing of EU-US relations. The choice of the EU to pass Regulation 868/2004 and the US decision to turn an EU proposal to hold off subsidies and renegotiate an agreement⁵ illustrates just how determined and bitter each side is. Boeing's acceleration of the process whereby aircraft manufacturers are becoming systems integrators will allow for new rivals to enter the market (Pritchard and MacPherson, "Strategic Destruction" 12). Systems integration involves transferring technology and capital into foreign suppliers' hands. Most likely this will come from Japan, which has already jointly developed a plane with Boeing dubbed the 7J7 (the "J" stands for Japan). The exposure of wrongdoing on each side will also seriously weaken the legitimacy of Western claims to the power of the free market and competition, a vital necessity in their efforts in the collapsed Doha round of WTO negotiations.

This dispute has illustrated that though EU-US relations are strong, they are not invincible. The acrimony and destabilization of trade relations associated with dispute proves that. However, there is a way out. In any WTO dispute the two parties are allowed to cancel the entire process through a mutually agreed settlement (WTO "Understanding"). DS316, DS317, DS353 and DS347 could all end right now if the US and EU would negotiate a behind-closed-doors settlement. Each side would have to offer the other a *mea culpa* and cooperate. The

³ SCM, 3.1(a)

⁴ SCM, 1.1(a)(1)(iii), 2.1

⁵ Newhouse 66

settlement would prevent the de-legitimization of the WTO and would provide an excellent example of the ability of interdependent governments to resolve conflicts in a civil manner. Will this happen? One can only hope.

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List of Acronyms

DSB -----	Dispute Settlement Body
DSU -----	Dispute Settlement Understanding
EADS -----	European Aeronautic Defense and Space Company
ETI -----	Extraterritorial Income
EU -----	European Union
FSC -----	Foreign Sales Corporation
GATT -----	General Agreement on Tariffs and Trade
LCA -----	Large Civil Aircraft
SCM -----	Subsidies and Countervailing Measures
US -----	United States
USTR -----	United States Trade Representative

WTO ----- World Trade Organization