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THE U.S. JET TRANSPORT INDUSTRY: GLOBAL MARKET FACTORS AFFECTING U.S. PRODUCERS

(109–20)

HEARING

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

MAY 25, 2005

Printed for the use of the
Committee on Transportation and Infrastructure

U.S. GOVERNMENT PRINTING OFFICE

22–499 PDF WASHINGTON : 2006

For sale by the Superintendent of Documents, U.S. Government Printing Office
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THE U.S. JET TRANSPORT INDUSTRY: GLOBAL MARKET FACTORS AFFECTING U.S. PRODUCERS

Wednesday, May 25, 2005

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON AVIATION, COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE, WASHINGTON, D.C.

The subcommittee met, pursuant to call, at 10:03 a.m., in Room 2167, Rayburn House Office Building, Hon. John L. Mica [chairman of the subcommittee] presiding.

Mr. MICA. I would like to call this hearing of the House Aviation Subcommittee to order. Although we have a memorial service going on on the steps of the Capitol and some members will be participating in that event and will be delayed, I would like to go ahead and start this hearing and keep it on time. And certainly we do remember the sacrifices and service of those in uniform as we begin this hearing today. With the permission of the minority, we are going to proceed.

The topic of today's hearing is U.S. Jet Transport Industry: Global Market Factors Affecting the United States Producers. The order of business before us will be two panels of witnesses, and we will begin today's hearing with statements from members and then we will turn to the two panel of witnesses that we have. I will begin with my statement and then yield to other members.

One of the most important responsibilities of the members of this subcommittee is to maintain fair international market competition for United States companies and their employees who manufacture aircraft. More than 600,000 men and women in the United States dedicate themselves every day to advancing the science and economics of flight by designing, producing, and delivering sophisticated aircraft to customers around the globe. Maintaining and even enhancing the vitality of this industry is critical to our domestic and international commerce. This morning, our subcommittee will focus attention on the recent Commerce Department report entitled, and I quote, ″The United States Jet Transport Industry. Competition, Regulation, and Global Market Factors Affecting United States Producers.″

This report was mandated in the Vision 100 legislation, our FAA reauthorization legislation, produced by this committee, and provides an ideal platform for the committee to hear testimony from leading United States Government officials and industry experts on the current state of our aerospace sector. The report and testimony we receive today will detail the unfair competitive practices by manufacturers in our country that they have experienced, and also

it will detail the resulting substantial erosion of United States market share as well as a reduction in the levels of employment in this country.

Let me clearly state, this administration and the United States Congress cannot and will not tolerate the unfair subsidization of manufacturing, promoting, financing, or the development of commercial aircraft. I believe that this Nation's aerospace industry is in a crisis in terms of its ability to compete on a level playing field. I am convinced that other Members of Congress from both sides of the aisle and from all political spectrums share this view.

We have witnessed a substantial decline in market share of our United States manufacturers over the past years. Key aerospace companies in the United States including Lockheed Martin and McDonnell Douglas exited the commercial aircraft manufacturing business in the 1980s and 1990s. Much of the decline in the domestic industry occurred at the same time the market share of Europe's Airbus was steeply increasing.

Understanding and addressing the current state of our U.S. aerospace industry is not a partisan issue. Last year, more than 240 Members of the House signed a letter to then U.S. Trade Secretary Bob Zoellick commending him for his dedication to ensuring that United States companies can compete on a level playing field, and also his decision to file a trade case at the World Trade Organization over the continued European government subsidization of its commercial aircraft manufacturer, Airbus. As most of the members of the subcommittee will recall, Senator Kerry was very vocal last year during the presidential campaign about the European's willingness to violate WTO subsidies agreement through what has totaled some 35 billion dollars that they have provided to Airbus over the years.

President Bush and his U.S. trade representative, Bob Zoellick, who just left office, and now our current U.S. trade representative and former colleague from Ohio, Rob Portman, along with Ambassador Allgeier, have been at the very forefront of our administration's effort to eliminate so-called launch aid to Airbus. Anyone who is reading newspaper editorials such as The Wall Street Journal, The New York Times, The Long Beach Press Telegram, The Denver Post, The Boston Herald, The Minneapolis Star Tribune, The Chicago Tribune, just to name a few, or watching television, realizes the concerns expressed today are not limited just to the U.S. Congress and to this administration. Many well-respected opinion leaders and editorial writers, in fact, around the globe, including those in Europe, have been particularly critical of the European government's continued use of government funds to support Airbus at a time when it has already achieved market share parity with its American competitors.

In a March 2005 Financial Times editorial—these aren't my words, this is the Financial Times British editor who wrote: Launch aid, Airbus's unique subsidy, is an especially blatant violation of the principles of fair competition. The EU should let go. State support for private companies becomes indefensible as they mature. Infant industries must grow up. And that is the end of that quote.

Where else can any other business secure a loan at deeply discounted rates of interest where the repayment of the loan is based on whether or not the business is considered an economic success? I think most people in the United States would love to be in a position to borrow money to buy a business or a house where they need not repay the loan if the person or company happens to be short of cash that year or the owner loses his or her job. Those terms have been, in fact, available to Airbus and its customers since its creation in 1969.

Here is another quote. This isn't Mica speaking or someone from the administration. In a German editorial, an editor recently wrote: This assumption of corporate risk by the state also gives Airbus the ability to pursue fantasies such as the A380, a monster of an airplane that might not have gotten off the ground without $3.7 billion in launch aid and another $1.7 billion in taxpayer-funded infrastructure improvements. Again, not my quote.

Unfortunately, the aerospace manufacturers in the United States have been forced to try to compete with companies that receive these massive subsidies provided by the combined treasuries of European governments. The European governments' aerospace agenda is, in fact, very clear. It is reflected in the comments of French Prime Minister Jospin in the year 2000. This is what he said: We will give Airbus the means to win the battle against Boeing. Not my quote, his quote.

Airbus's deliveries in 2003 and 2004 of more commercial aircraft than Boeing for the first time in history suggests that they are not far from reaching this goal.

The United States, I believe, must draw a line in the sand and make it impossible and take every possible measure to stop the unfair subsidization of the development, manufacture, promotion, and financing of commercial aircraft. All commercial aircraft. Furthermore—and when I say all commercial aircraft, we are also looking at other subsidization by other foreign manufacturers, and we are going to deal with that in additional hearings and meetings.

Furthermore, those who may deal in the tactics of bribery or government inducements violate international standards and will be held accountable.

I have begun to take steps to make certain that they will be held accountable.

Linkage between a foreign airlines receiving preferential treatment for landing rights or slots from airports if the company purchases Airbus aircraft is also under review by this subcommittee. International intimidation as was demonstrated in the case of a Turkish airline where its purchase of Airbus aircraft last year was allegedly linked as a condition for Turkey's admission to the European Union, is another practice that bears scrutiny. An article in U.K.'s Economist of June 2003 entitled: Aircraft and Bribery: Airbus's Secret Past, raises some very serious questions about these tactics that have been routinely used for decades. And, again, I have taken measures and steps to look into and further investigate and take actions against these practices.

If the Congress and the administration do not act now to level the playing field for United States manufacturers of aircrafts and engines, then the 600,000 men and women who still remain in the

aerospace industry, our entire aircraft manufacturing sector I fear will be eliminated from the international marketplace.

We look forward to hearing from our distinguished witnesses on these and other issues affecting United States aerospace industry.

I am pleased now to recognize the ranking member of this subcommittee, Mr. Costello.

Mr. COSTELLO. Mr. Chairman, thank you. And, Mr. Chairman, I apologize for running late. I had a group of college students in my office, and they vote in my district so I spent a little bit of time with them.

Mr. MICA. I should have said this, and I apologize. Just a second.

Don't ever try to stop a hearing that I announce. I just want to give people a warning. Do not ever try to stop a hearing that I have announced. Thank you.

Mr. COSTELLO. Is there a message here, Mr. Chairman, that we are not—on our side of the aisle?

Mr. MICA. No, it is not to your side. In fact, you have been most cooperative and I appreciate that.

Mr. COSTELLO. Okay.

Mr. MICA. You just came in at the end here. And I just want to make it clear that this subcommittee will not be intimidated to push issues of national significance aside by intimidation or by whatever means.

Mr. COSTELLO. Mr. Chairman, thank you. Again, I apologize for running late. I will submit my statement for the record, and ask unanimous consent that all members submit their statement for the record.

Mr. MICA. Without objection, so ordered.

Mr. COSTELLO. Mr. Chairman, I thank you for calling today's hearing to examine the competitiveness of the U.S. aircraft manufacturing industry. We must do everything that we can in the Congress to ensure that U.S. companies can compete on a level playing field.

Mr. Chairman, the United States must make a strong stance against trade barriers that hamper U.S. manufacturers from competing on a level playing field. I look forward to hearing from our witnesses today, in particular, our U.S. trade ambassador, and concerning the issues of the European Union before the World Trade Organization regarding the subsidies provided to Airbus. I think we have to take a hard look at the lack of adequate funding for basic aerospace research and development, which is a significant impediment to the future of the U.S. large civil aircraft manufacturing industry in the United States. NASA's research budget has steadily declined over the last decade from a high of 1.54 billion in fiscal year 1994 to the fiscal year 2006 budget request of $852 million.

To understand the effects of this lack of basic R&D funding on the aerospace industry, I have requested that the Government Accounting Office conduct a comprehensive assessment of U.S. aeronautical research and development efforts and a comparison of these efforts with those of the European Union and other nations.

Mr. Chairman, I look forward to hearing the testimony of our witnesses today, and, as I said, I will submit my entire statement for the record.

Mr. MICA. I thank the gentleman. Are there other opening statements? Mr. Westmoreland.

Mr. WESTMORELAND. Thank you, Mr. Chairman. I appreciate you having this hearing, and I think everybody out here realizes your commitment to making sure that our manufacturers are on an equal playing field. I just want to say that I look forward to hearing from all the witnesses, and especially Mr. Bryan Moss from Gulfstream Aerospace in Georgia, which does a wonderful job of manufacturing planes that people use all over this country. And I look forward to hearing his testimony because they are an example of what kind of product American companies can produce. And hearing his testimony as to not only the unfair competitiveness I guess that we do from foreign countries being able to subsidize other things, but even the own regulations that we do within our own country to hurt the people that manufacture here. So, Mr. Chairman, that is all I need to say.

Mr. MICA. Mr. Larson.

Mr. LARSEN. Mr. Chairman, thank you to you and Ranking Member Costello for holding this hearing. I want to start by thanking the administration and the office of the U.S. Trade Rep for the work that they have done in attempting to reach an agreement with the European and to end the subsidies to Airbus. This is of importance to my district located in the Puget Sound region of Washington State, which is home to the largest Boeing commercial facility. My district has seen first-hand what competing with an unfairly subsidized organization can do. In the past five years, Boeing has cut overall employment by more than half, from 104,000 employees in 2000 to a little over 50,000 employees today. Most of these employees, both those currently working and those laid off, live in Puget Sound. A factor in the loss of these jobs has been Airbus's remarkable pace of growth and continued increase of industry market share, an increase that would be commendable, but for the fact that it is buoyed by the unfair practice of launch aid.

Airbus's global market share of aircraft deliveries skyrocketed from roughly 25 percent in 1992 to 52 percent in 2003. I strongly supported the USTR's decision last October to end the US-EU 1992 agreement on aircraft and request WTO consultations on a new agreement.

The 1992 agreement to allow 33 percent of Airbus's aircraft development costs be funded through launch aid has run its course. I was encouraged when the U.S. and the EU reached agreement on negotiation terms that would end subsidies, but let us be clear, the subsidy is exactly what launch aid is. And through the work of the USTR, the EU has agreed to use a definition of subsidy in the WTO subsidies agreement as a foundation for the new agreement. Although these discussions have stalled, again, I want to emphasize, I want to thank former USTR Bob Zoellick for his commitment and persistence in working to resolve this issue, and look forward to the new USTR, our former colleague, Mr. Portman, to continue to make this issue a top priority.

EU's continued launch aid for Airbus is unacceptable and must end. Launch aid for Airbus consists of no or low-interest government loans for up to a third of the cost of new Airbus aircraft. Repayments of many of these loans are dependent upon the sales of

Airbus aircraft. If Airbus does not sell the amount of planes it targets, it simply does not pay that portion of the loan. Therefore, a third of the risk does not sit with the company, but rather with the treasuries of its government sponsors. This is an incredibly unfair advantage for Airbus. Launch aid once perhaps served a purpose in getting Airbus off the ground, but that time has long since passed.

Airbus is clearly a mature company that does not need risk-free government loans to be competitive. In order for American workers to succeed in the aerospace industry and in all industries, they must be allowed to compete on a fair and level playing field. When the playing field is neither fair nor level, good paying jobs in the U.S. are lost.

I look forward to continuing to work with the administration, the USTR, and this subcommittee to bring an end to these unfair subsidies. Thank you, Mr. Chairman.

Mr. MICA. I thank the gentleman. Any other members seek recognition? Mr. Ehlers.

Mr. EHLERS. Very briefly, Mr. Chairman. I just want to thank you for calling this hearing. I think it is one of the most important hearings we are going to have. I am tremendously bothered by the unfair competition that we face, and I really appreciate you calling the hearing. Thank you.

Mr. MICA. I thank the gentleman. Mr. DeFazio.

Mr. DEFAZIO. Thank you, Mr. Chairman. Thank you for this long overdue hearing.

You know, I recall a conversation I had with senior management at Boeing back during the early Clinton era and the negotiation of the first WTO agreement, and I suggested to them that this was a defective agreement, that the agreement did not deal with aviation subsidies. And they said that they didn't want to raise those issues. They were confident in their company, confident that they could deal with this, and also had fear that some of their customers were European airlines that might retaliate if they took steps to just create a truly competitive market in dealing with Airbus.

Well, those executives are long gone and probably living in very large homes with wonderful capital accumulation, but many of their employees have lost their jobs and more will lose their jobs because of the shortsightedness of both the company at the time in terms of taking on this issue and pushing the administration and discouraging those of us who would have done that. Entering into an agreement as a Nation can be faulted on President Clinton and this administration for these so-called free trade policies that are hemorrhaging our industrial might, sending family wage jobs overseas, allowing unfair competition, allowing intellectual and technological blackmail by countries such as China.

The problems do not begin and end with subsidies to Airbus; they are much larger. And, in many ways, the Europeans are more enlightened than we are in looking at an absolutely critical sector that can provide very high wage jobs and provide technologies that have both civilian and military application and act to protect it and promote it.

Whereas we enter into this sort of bizarre laissez-faire view of trade where we let the Chinese steal and/or blackmail U.S. compa-

nies for their best technology. We have until very recently allowed Airbus to receive extraordinary subsidies without even raising a peep; and we allow company leaders to pursue the offshore movement of technology jobs, chasing the cheapest labor around the world.

So the problem is much bigger for the United States of America than what we are confronting here today, but at least we are beginning to take on one aspect of this problem with the launch aid subsidies. And there are other subsidies that go there. If you buy an Airbus, you are probably going to find you might be able to get a slot at an airport in Europe that you couldn't get if you happened to buy a Boeing and wanted to land there. So there are many other ways in which they have been promoting, and, again, in a way that certainly shows the United States with its laissez-faire philosophy is losing out in the world market here.

I am not tremendously confident in the dispute resolution of the WTO. It does not follow the rules of jurisprudence, it doesn't have any rules regarding conflict of interest, and it is a very faulty process. But we should pursue this as hard as we can. I don't know what the chairman was referring to in terms of people trying to short-circuit this hearing, but I think it is a timely hearing. I wish that we did have people from Airbus here because I have questions I would like to ask of them regarding this, and hopefully at a future date we will. Thank you, Mr. Chairman.

Mr. MICA. I thank the gentleman. Additional opening statements from members? Ms. Norton. And, thank you, Ms. Norton. I understand today at 3:00 they are going to sign off, media stations, we finally succeeded at least some plan for reopening Reagan National. I thank you. Mr. DeFazio worked on it, Mr. Costello, and members on both sides of the aisle, Mr. Davis, Mr. Moran. So thank you. And you are recognized.

Ms. NORTON. Well, thank you, Mr. Mica. Indeed, I was going to begin by thanking you for this extraordinary breakthrough. It has been 4 years, and it has not been my four years; it has been this entire committee each and every step of the way, the ranking member sitting at the time Mr. DeFazio was with him, Mr. Costello, and the chairman of the committee, Mr. Young. But, Mr. Mica, I particularly appreciate that you held a hearing and the anchor that I think really sent the message home that Congress, the committee took very seriously the notion that general aviation was down in Reagan and up everywhere else including New York right after 9/11.

So I can't say enough to thank the committee for the way in which it has led this effort. And I think that the bill that you marked up in April was the final message and was the reason that we have this breakthrough now. There are some encumbrances that are completely unjustifiable, and I think that, as time goes on, we will be able to knock those down. The notion you have to land a corporate jet before you land in D.C., have an air marshal get on armed, and then proceed to National really does once again send the message that, in 4 years, we haven't learned to protect our own Nation's capital. That is not true.

And I ask the committee to look further at the encumbrances so that we can get going. There are some things perhaps we ought to

be doing here that we don't do other places, but some of these encumbrances simply cannot be justified.

I did want to say a word, Mr. Chairman, about this hearing, because I think this is a very important hearing. You have recently had hearings on the state of the airlines themselves and hearings that were very important as we look at the future of the aviation industry and our country.

This is very troubling. This issue is very troubling. This is an industry, one of our most highly skilled industries. It has been—it is being miniaturized before our very eyes, lost half its employees in the last 15 years, yet it has kept a positive balance, trade balance when at odds with what the country at large has done. We can't afford to lose this industry, especially for the reasons it appears that it is experiencing some trouble, and that is government involvement and with the competition, launch aid and other such activities.

We have got to find a way not to be the only country who follows trade rules and the rules of ordinary commerce. And when others do not follow them, we have simply got to step up and take the appropriate action before we lose yet another major industry in this country. So I am particularly grateful for today's hearings, Mr. Chairman.

Mr. MICA. I thank the gentlelady.

Mr. Poe.

Mr. POE. Thank you, Mr. Chairman. Having lived in Texas where we have numerous Boeing employees, this hearing is very important. I appreciate you, Mr. Chairman, having this hearing. We know what the problem is: The European Union is determined to create an advantage for Airbus in spite of agreements, in spite of the rule of law by any means necessary. In any event, Boeing is one company that still competes well, but I look forward to some answers to this problem now that we know what the issue is. I look forward to the answers coming from both of our panels today. So thank you, Mr. Chairman.

Mr. MICA. Mr. Pascrell.

Mr. PASCRELL. Mr. Chairman and Ranking Member Costello, I have been long pressing for the Federal Government to develop a national manufacturing policy in the legacy of Alexander Hamilton. Under our Nation's trade policy, we have seen the steep decline in our manufacturing base in general. For the past 2 centuries, our Nation has grown its economy based upon production, the production of our grandparents and our parents for the most part. If we believe that service jobs alone will sustain our position in the world, I think we are kidding ourselves. We are also delusional if we do not see the manufacturing capacity as essential to the national security of this country. And I believe the government is an accessory to the fact of that decline.

Trade deficits are growing as far as the eye can see. We are entering into free trade pacts without any coherent strategy. These agreements are more like investment deals where we are encouraging firms to move jobs offshore. It is no secret that in particular, domestic airline manufacturing industry is in dire straits. Tens of thousands of Boeing employees have lost their jobs in the last year.

The administration needs to play hardball with the European Union to bring Boeing and its workforce the level playing field that it deserves. With so many American jobs on the line, if the World Trade Organization cannot solve this dispute properly, I think we should seriously think of putting that organization out of its misery.

Along with international trade I think we must take care of business at home and plan for the future. We must increase funding for research and development, and educational opportunities for our students to prepare them for the necessary engineering and problem solving skills. Too many firms are packing up and expanding their R&D operations overseas. In our budget, these are certainly not the priorities we have seen. I am hopeful that hearings such as this one will convince us to reexamine how we are spending our resources.

And I know this is not a simple matter. I know that Airbus, up to 40 percent of the value of the Airbus airplane can original in the United States. I am very aware of that. I am also aware that Airbus spends in excess of $5 billion in the United States. But the fact of the matter is I think that what I have said previous still holds. And I would like to hear from the two folks who are in front of us a coherent approach and not simply a focused approach to forget about what the umbrella problem is. Thank you, Mr. Chairman.

Mr. MICA. I thank the gentleman. Any other additional opening statements? If there are no additional statements, we will turn to our first panel. And we have two witnesses. The witnesses are Ambassador Peter F. Allgeier, Deputy United States Trade Representative, and the Honorable Joseph H. Bogosian, Deputy Assistant Secretary for Manufacturing of the United States Department of Commerce.

TESTIMONY OF AMBASSADOR PETER F. ALLGEIER, DEPUTY, UNITED STATES TRADE REPRESENTATIVE; AND HON. JOSEPH H. BOGOSIAN, DEPUTY ASSISTANT SECRETARY FOR MANUFACTURING, UNITED STATES DEPARTMENT OF COMMERCE

Mr. MICA. I would like to welcome both of you, and recognize Ambassador Allgeier first.

Mr. ALLGEIER. Thank you very much, Mr. Chairman. I would like to thank you and Ranking Member Costello and the other members of this subcommittee for providing the opportunity today to address this very important issue of the U.S. civil aircraft industry and the factors and policies affecting our producers.

Today I wish to focus on a particular global factor affecting our producers, and that of course is the subsidies for the development and production of large civil aircraft, and on the administration's ongoing efforts to end the subsidies to the European aircraft manufacture Airbus.

Today I will discuss some historical background on the subsidy issue, but I would like to focus on our efforts working with our industry to end EU aircraft subsidies.

As we all know, Airbus was established in 1970 as a European consortium of French and German and then later Spanish and U.K.

companies. Ultimately, it became a single integrated company, 20 percent owned by BAE Systems of the U.K. And 80 percent owned by European Aeronautic Defense and Space Company, EADS. And EADS itself is 15 percent owned by the French state, 5 percent owned by Spain.

Over its 35-year history, Airbus has benefited from massive amounts of subsidies from EU member states and from the EU itself, and these subsidies have enabled the company to create a full product line of aircraft and to gain more than a 50 percent share of the global large civil aircraft market.

Every major Airbus aircraft model was financed with government subsidies taking the form of launch aid, that is financing with no or low rates of interest, and repayment tied to and entirely dependent on the sales of financed aircraft. In addition, EU governments have forgiven Airbus debt, have provided equity infusions, have provided dedicated infrastructure support, and have provided substantial amounts of research and development funds benefiting civil aircraft projects.

Since 1985 the United States has been involved in several rounds of negotiations with the Airbus partner governments and with the European commission itself, with the objective of achieving greater discipline over the subsidies provided to Airbus. In July of 1992, the two sides negotiated a bilateral agreement limiting government support for large civil aircraft programs.

That agreement included a prohibition on future production support and a limitation on the share of government support for development of new aircraft models limiting it to 33 percent of the project's total development costs. Three years—so at that point there were no multilateral rules that applied here. In 3 years later, however, the WTO subsidies agreement entered into force, and that agreement applies in full to subsidies of large civil aircraft. If a member provides a subsidy that is inconsistent with the agreement's terms, it is subject to challenge at the WTO.

Now, despite these obligations, the EU has continued to subsidize Airbus. The $3.7 billion that you mentioned, Mr. Chairman, in launch aid that they have—the European governments have committed for the A380, the super jumbo, was the largest amount of funds committed for a single project. And, as you pointed out, the EU provided further loans and infrastructure support that pushed the total amount of subsidies to the A380 to date to approximately $6.5 billion. Now we see that Airbus is on the verge of launching another new aircraft, the A350, and it has requested to date $1.7 billion in risk-free launch aid for that aircraft as well.

Mr. Chairman, our current effort to end the subsidization of Airbus began early last year when it became apparent that EU member states were considering subsidies for this newest plane, the A350. President Bush instructed the U.S. Trade Representative to pursue all options to end the subsidization of Airbus, including the filing of a WTO case if that were necessary. The U.S. industry has fully supported this approach.

Unfortunately, the EU was not willing to agree to the goal of ending new subsidies. Therefore, on October 6th of last year we initiated the first stage of dispute settlement proceedings at the WTO. We also exercised our right to terminate that 1992 agreement.

On January 11th, when we were on the verge of moving to the next stage of our WTO challenge, we reached agreement with the incoming trade commissioner of the European Union, Peter Mandelson, on a framework for negotiating an end to subsidies. We agreed with the EU at that time on a 90-day time frame for the negotiations, and the agreement included a common goal explicitly stated in writing of ending subsidies as defined by the WTO subsidies agreement.

In March, however, EU officials backed away from the agreed objective of ending the subsidies because certain EU member states want to continue providing launch aid and subsidies to Airbus, in particular for the Airbus A350. Now, the EU argues that it needs to continue providing launch aid to offset subsidies that Boeing allegedly receives from NASA and the Department of Defense. There is no basis for the EU's claim. We do not agree that NASA and defense contracts provide subsidies to Boeing's production and development of large civil aircraft.

And, in any event, Airbus and its parents, EADS and BAE systems, have space and defense businesses that rival that of Boeing, but only Airbus receives launch aid. There is no similar type of financing available in the United States. Launch aid, as a number of the members have already pointed out, is a particularly distortive type of subsidy because it shifts enormous up front expense and commercial risk of developing new aircraft from Airbus to European taxpayers. If Airbus guesses wrong about the project of a particular aircraft, it does not need to repay the money. Moreover, because repayment is tied to sales, Airbus receives a substantial grace period before it needs to begin repayment. For example, Airbus has not even begun repaying the $3.7 billion that it received 5 years ago for the A380.

Mr. Chairman, the administration continues to believe that a negotiated outcome that ends launch aid and other WTO incompatible subsidies would be the preferred route for resolving this matter. But let me be clear. If we conclude that a negotiated solution to end the subsidies is not possible in the near term, we will return promptly to the WTO. We are working very closely with the industry on this strategy. The administration is committed to ending the subsidization of Airbus and to establish a level playing field for trade in large civil aircraft. It is up to the Europeans to decide if they are prepared to withhold all launch aid while negotiating an agreement, or if they would rather take their chances in a WTO dispute proceeding.

We look forward to working with you, Mr. Chairman, the members of this subcommittee, other interested members of Congress, and of course the U.S. industry to stop the unfair subsidization of Airbus. Thank you very much.

Mr. MICA. Thank you. And we will withhold questions until we have heard from our second witness, who is the deputy assistant secretary for manufacturing, Joseph Bogosian. Welcome. And you are recognized, sir.

Mr. BOGOSIAN. Good morning, Mr. Chairman, Ranking Member, and distinguished members of the subcommittee. On behalf of the U.S. Department of Commerce, thank you for the opportunity to

share our views today. I would like to submit my written testimony and our report for the record, and make a brief opening statement.

Working in the International Trade Administration, I oversee our 12 manufacturing industry teams, including aerospace. Our mission is to advance U.S. commercial economic competitiveness. Namely, we identify policy challenges, we analyze data to develop policy positions, and we advocate those positions domestically and internationally.

Mr. Chairman, as you know, pursuant to Congress's request, the Commerce Department in collaboration with other agencies recently submitted the U.S. jet transport industry report. It examines the industry, reviews relevant international trade agreements and provisions and U.S. and European government policies, and identifies potential obstacles confronting U.S. manufacturers in an increasingly global market.

The U.S. commercial aerospace companies involved in the production of large civil aircraft have lost significant global market share over the last 25 years primarily to their European counterparts. We went from three U.S. manufacturers of large civil aircraft in the 1970s to only Boeing today. A subsidized 35-year-old Airbus delivers more new commercial aircraft than Boeing and has received more orders for new aircraft five out of the last 6 years. Canadian and Brazilian regional jets increasingly are being used by airlines on routes that once were served by Boeing and Airbus aircraft. The two U.S. manufacturers of large civil aircraft engines have experienced similar, though less drastic losses of global market share to their European competitors. U.S. parts and components companies face more difficulty maintaining their market share in an increasingly global industry. They will increasingly look to non-U.S. manufacturers for a growing percentage of their business.

Aerospace manufacturers and countries such as Russia, Japan, South Korea, and China will continue to build their expertise and market share. Passenger and cargo airlines also have undergone a significant transformation since deregulation in 1978. Today, legacy airlines are struggling to stay solvent, and low cost carriers are a formidable presence.

The evolving market has led to new demands for aircraft models with new capabilities and changes in the way aircraft are purchased and operated. These market-based factors have brought changes to the U.S. aerospace manufacturing industry.

I now turn to the nonmarket factors such as government policies, funding, and regulations that have also brought significant change.

In our report, we review 12 policy categories; I will discuss a few of those today. Trade agreements have done much to liberalize and level the international playing field for the aerospace industry. Many of these agreements need to be updated to keep pace with the evolving industry. Foreign government financial support to aerospace manufacturers is a very critical obstacle to fair and open global trade. The report lays out this issue in detail, and Ambassador Allgeier described the problem and how the U.S. government is vigilantly addressing this concern.

Nontariff barriers such as standards and regulations will have an increasingly significant impact on U.S. aerospace exports. For-

eign government standards and regulations should not have a discriminatory commercial impact against U.S. products like they have in the past. Regulations should have a scientific basis and take commercial realities into consideration. This is particularly important right now as Europe develops environmental standards regarding emissions and noise and as manufacturers seek safety certification for their new and innovative aircraft.

The air transportation system's ability to grow is limited by government regulations and old technology. Increasing liberalization of air services and improvements to air transportation systems will open new markets for air passengers and cargo and support aircraft sales.

The United States has led the world in fighting bribery. Unfortunately, problems still remain. We encourage foreign governments to strengthen and fully enforce these laws so U.S. companies can compete fairly.

Existing government aircraft finance rules and regulations have helped neutralize the role of export financing. These provisions, however, need to be updated to reflect current commercial financing practices and the emergence of the two new major jet transport manufacturers.

At the conclusion of the report, we outline our ongoing current efforts to address the challenges we have identified. Here are some of those efforts:

We are working to update multiple aerospace-related trade agreements and policies so that they will accurately reflect the state of global aerospace and airline industries. We are seeking recourse through the WTO and through bilateral negotiations to bring an end to subsidies for development of new large civil aircraft. We are working with our foreign counterparts through the OECD to update international aircraft finance and bribery provisions. We are working with other countries to develop new global standards and recommended practices, and with other agencies here at home through the JPDO to transform the air transportation system.

We are conducting negotiations aimed at increasing liberalization of international air services that will further support expansion of the global aviation system.

Overall, we remain vigilant in addressing all these nonmarket factors impacting U.S. industries' competitiveness.

Again, Mr. Chairman, Mr. Ranking Member, thank you for this opportunity to discuss with you our report and findings. There are many things that we can do together in support of our shared constituency. I look forward to today's discussion and, probably more importantly, to working with you beyond today's hearing. Thank you.

Mr. MICA. I thank both of our witnesses. And we will start with a couple of questions.

One of the problems that we seem to have is getting hard financial information on the extent of some of the subsidization. Airbus and its parent company do a lot of business, or attempt to do business or are attempting to do additional business in the United States. Ambassador, are our financial reporting requirements adequate and transparent enough that, under current law, we have

the information we need to go after Airbus and its parent company in some of these trade disputes?

Mr. ALLGEIER. Mr. Chairman, just to let you know and the other members of the subcommittee know that we are fully prepared to move forward promptly in the WTO. Our legal team has been working for many months to pull together the material that we need to make a very strong case in the WTO.

Mr. MICA. Do you need any additional legislative authority to probe finances which are sort of guised in international corporations, but may not be transparent?

Mr. ALLGEIER. I don't think that we need additional legal authority at this point. It is not hard to see $15 billion subsidy.

Mr. MICA. All right. There was a previous case and ruling similar in nature, I believe it was a Canadian case, that set some precedent in the WTO in 1994, was it? Does this provide us with a ruling that would also indicate we would have favorable results if we pursue this with WTO?

Mr. ALLGEIER. The case that you are referring to was one involving Brazil and Canada. Their Embraer and Bombardier programs. It did help to clarify some of the rules with respect to subsidization focusing primarily on export subsidies. What we are looking at here is a somewhat different kind of subsidy, but we certainly, as I said, feel confident that we have a very strong case.

Mr. MICA. Is some of that aid in the form of what they call royalty-based loans? How does this differ, and can you explain again how you feel this is unfair subsidization?

Mr. ALLGEIER. Well, yes. Very clearly, the kind of—well, there are various forms of support that Europe provides. The most egregious one, in our view, is this launch aid, which is money that is provided to Airbus. And, as we have said, Airbus does not have to pay that back at all unless they are successful in marketing that particular model. And so that is the particular kind of launch aid that is, as I said, most egregious. But there also are other forms of support that Airbus receives that we believe fall within that definition of the WTO agreement on subsidies.

Mr. MICA. What is the WTO standard for determining whether such government assistance violates international trading disputes?

Mr. ALLGEIER. There are a number of elements to that. First of all, whether there is a financial contribution that provides a benefit to the company receiving it. And that financial contribution can take a number of forms. It can be a direct transfer of funds, grants, loans whatever. It could be foregoing government revenues or taxes. It could be the provision of government goods and services that are not at a market rate. The subsidy, the transfer must be specific to an enterprise or an industry—fits the bill here—and, if it is something other than an export subsidy or a domestic content requirement, it must have an adverse effect. And obviously, if you look at the market share that Airbus has been gaining year after year, there is clearly an adverse effect upon U.S. industry.

So, for all of these different elements, we think that the support that is provided to Airbus fits within that definition clearly, and therefore should be ended and the subsidy should be repaid.

Mr. MICA. Thank you.

Mr. Bogosian, over the past years aviation industry manufacturing has been one of the lead export areas of the United States. We are now running trade deficits excess of $700 billion a year. In the past, one of our success areas in export has been commercial aircraft products from our aviation industry. What is the recent record as far as the effect on our trade deficit? Do you have that information?

Mr. BOGOSIAN. What we show is that U.S. aerospace still leads in terms of trade surplus as an overall industry sector. And given—

Mr. MICA. Hasn't that been on a decline at least the last 5 or 6 years?

Mr. BOGOSIAN. It certainly has. And that is why it is time to stop the bleeding, and we have to take action on very specific aspects of this.

Mr. MICA. The last question will be, Ambassador, you said the President and the administration are going to explore all options. And I think Mr. Pascrell said he wants to hear, and I want to hear, what other steps that we have. We have the WTO. We have Congress now getting involved. We will probably be taking some steps to address this. I asked if you needed additional legal authority in the financial area or any other realm to stop the bleeding, so to speak. What does the Department of Commerce, what does our USTR propose? Are there any other options or anything that we can do to assist? Ambassador, and then we will get Mr. Bogosian.

Mr. ALLGEIER. I think the most important thing is what you are providing here today and what you and the other members have provided, which is, one, shedding light on these practices by the Europeans so that everybody here understands the magnitude and the trade distorting nature of them. And then, secondly, to support us as we move forward either in an effective negotiation or in effective litigation.

Mr. MICA. Mr. Bogosian.

Mr. BOGOSIAN. As Ambassador Allgeier mentioned earlier, the support in this case in terms of Boeing-Airbus issue comes in many different forms. Launch aid is just one of them. There is also government assumption and forgiveness of debt. There is also direct infusions of capital, government-funded manufacturing facilities--all this support basically goes from the European government treasuries to the benefit of private corporations. In 1998 and 1994, for example, the German government gave 2.33 billion deutschmarks to assume privately held debt. So even beyond the royalty based loans that Airbus was operating under, this is the private debt that Airbus had taken on and the German government gave 2.33 billion deutschmarks in 1988 and 1994 to assume that privately-held debt.

In 1997 and 1998, the German government forgave 7.34 billion deutschmarks of the royalty based loans or the government debt that had been given out. So, not only do they benefit from the royalty-based loans and the market distorting factors and the assumption of risk by the government for the launch of a private product, they also benefit when those loans are forgiven.

Infusions of capital, again, are things that are pretty much unheard of and just unfair for a 35-year-old mature company. The French government provided 2 billion francs as an equity infusion

to Aeroespatiale which at the time was an Airbus consortium partner which is now in one corporate entity. That was in 1987. And in 1994, another 2 billion francs, again, as just a direct check and equity infusion from the government into a private company's coffers.

The WTO case, I believe, addresses these types of things, goes after these types of things. As to your question, one of the other matters that we are addressing is bribery, for example. I know some of the members talked about that in their opening remarks. The Commerce Department recently put out a study on the bribery issue. I can share that with the committee after today's hearings. But bribery was a very serious issue. You had companies basically writing off their bribes in their tax returns in Europe. U.S. companies were operating under the Foreign Corrupt Practices Act. Our guys can go to jail; their guys can take a tax write-off. Well, we finally got the bribery convention within the OECD, and so now what we are working on is thay it's all well and good that we have the bribery convention, but we need to see actual laws put into place that are as tough as the Foreign Corrupt Practices Act. And then we need to see the enforcement of those laws to really shake those people in their boots and do something about that.

So there are a number of fronts that we are working on on this overall trade issue, on the trade balance issue, and bribery is yet another one. And there are so many more that we can talk about.

Mr. MICA. Thank you. And we may be looking at some measures where people guilty of that kind of activity are prohibited from conducting their business in the U.S. or with the U.S. or any of its entities. As I said in my opening remarks, we will follow up on that aspect.

Mr. Costello. Thank you.

Mr. COSTELLO. Mr. Chairman, thank you.

Mr. Ambassador, we have heard about these subsidies for a number of years. We have just heard testimony this morning; and, in written testimony, there is documentation about subsidies going on for a number of years.

I am wondering, one,finally in 2004, we filed a complaint with the WTO. Why did it take so long for our government to act in filing this complaint?

Mr. ALLGEIER. Yes, in this dispute, as in others, we strive to work very, very closely with the affected U.S. interest, the affected U.S. industry. For several years, the industry's position was that we should seek a reduction of the support, but there was concern at the other ramifications if we were to take a WTO case, other ramifications in terms of the effect on their sales in some of these European markets.

Basically what happened is, as time went by and they saw their market share eroding, they determined that the balance of interest was in a more aggressive approach with respect to the WTO. We have agreed with them on that, and that is why we terminated the '92 agreement and initiated these WTO proceedings.

Mr. COSTELLO. In your testimony, you indicate that the administration would prefer to negotiate a settlement; and I wonder if you might tell us, for the record, what the prospects of a settlement are at this point?

Mr. ALLGEIER. First of all, let me be clear that our preference is to negotiate a certain kind of settlement, not just any settlement. The certain kind of settlement is one we have been extremely clear on, and that is to eliminate the subsidies, not simply to put a cap on them.

Frankly, as we read the papers in Europe—and we follow this matter closely—I must say that it appears to me that at least some of the European member states remain convinced that they need to provide launch aid to Airbus; and, unless that attitude changes, the prospects for a negotiated settlement are not high.

Mr. COSTELLO. There are some who would argue that Boeing receives subsidies. You touched on the issue of those who believe that, because of the research and development done by NASA, that Boeing has benefited, and they see that as a subsidy to Boeing.

There are others who would say that Boeing receives direct—or indirect subsidies through State and local tax incentives. I wonder if you might want to elaborate a little bit on the issue of does Boeing receive a subsidy because of the R&D from NASA and then the other tax incentives by State and local government.

Mr. ALLGEIER. We have no doubt that if the United States proceeds with a case in the WTO against Europe, that Europe will file a counter case; and they will allege in that case that there are subsidies in violation of the WTO agreement received by Boeing. We certainly are fully prepared to defend U.S. interests if such a case is filed by the Europeans.

Mr. COSTELLO. Well, you specifically mentioned a minute ago in your testimony that it is your opinion—it is our government's opinion that Boeing is not receiving a subsidy, it would not be considered a subsidy, the R&D through NASA; and I wonder if you want to clarify that.

Mr. ALLGEIER. As I mentioned earlier, in sketching the elements of the WTO agreement on subsidies, there are a number of factors that have to be taken into account. One of them is the specificity of any sort of support; that is, specificity that is going to a particular company for the production and development of large civil aircraft. The kinds of programs certainly that I understand that NASA provides are more general programs in the area of space exploration and so forth.

So we feel that those are a different kind of engagement with industry than the launch aid, which is so clearly aimed at the production and development—or the development of large civil aircraft.

Mr. COSTELLO. I wonder, finally—a final question, if you would walk us through how the dispute settlement mechanism is with the WTO, how a panel is requested and how the process works, as well as the time frame of litigating a case with the WTO?

Mr. ALLGEIER. Yes. I mean, the first step in a dispute settlement process is to ask for consultations with the other party. That is what we did in October. We held those consultations in November. There is then a waiting period before one can ask for a panel. That waiting period has already expired. So that is the stage in the proceeding where we are right now.

We were ready earlier this year—at the end of last year, I should say—to go and request a panel when the new European trade com-

missioner came to us and said, I would like to see if we can solve this through negotiations.

Now, if we go further in this process, we will ask for a panel to be assembled. A panel is then assembled from trade experts; and we must agree to the members of that panel, as must the European Union. So that is the process for getting a balanced or an unbiased panel.

Once the panel is formed, then each side comes in with its brief, written submissions and oral presentations, and there is a back and forth, a number of rounds. Then, ultimately, the panel makes what is called an interim finding, which is shared confidentially with the parties. We get a chance to respond, and then they come out with their final determination.

At that point, either party can ask for an appellate body to review that panel. The appellate body reviews it. There is a very compressed time frame for the appellate body to do that, and then the appellate body comes out with its ruling.

Under the WTO, as opposed to its predecessor, the GATT, the parties are required to comply with that finding. It used to be that if a party objected it didn't have to comply. Well, that wasn't a very effective dispute settlement process. So this is the process that we have now.

Obviously, the time frame varies depending on the complexity of the issue. This is a complicated issue. Normally, one would expect there to be an 18-month, 2-year period to go through this process, which is one of the reasons that we think that we should look to see whether we can deal with this more efficiently or more quickly through negotiations. But I want to emphasize we are not going to sit around forever assessing whether to move forward with litigation.

Mr. COSTELLO. If you have to go forward with requesting a panel, is there time—are there the deadlines for the panel? Once the panel is assembled, both sides make their case, is there a deadline for the panel to make a finding or a recommendation?

Mr. ALLGEIER. There are general time frames that apply to the dispute settlement process. Then each panel has to work within those time frames to set the precise timing for how much time they are going to allow for people to prepare their briefs and how much time for rebuttal and then how much time they need to reflect on that and come to their judgments.

Mr. COSTELLO. So what are we blankly looking at here, if it goes to a panel? From the time that the panel receives and concludes the arguments, receives the testimony, when are we likely to find a ruling or determine a ruling?

Mr. ALLGEIER. If we were to walk into the WTO today and say we want to restart the process and we want a panel formed, I think realistically we are looking at 18 months to 2 years.

Mr. COSTELLO. Thank you, Mr. Chairman.

Mr. MICA. I thank the gentleman.

Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman; and thank you for calling this very important hearing.

Mr. Ambassador, everyone knows that the House Ways and Means Committee is the most pro free trade committee in the en-

tire Congress. In fact, no one is placed on that committee unless they are strongly in favor of free trade. Yet in the Congressional Quarterly today's publication has a report saying that, just yesterday, in discussion on a resolution concerning the World Trade Organization, that almost all the panel members had very critical comments about the WTO, including Chairman Thomas, who apparently was quoted as saying at one point,quote, because we are big, they think we can take any kind of pounding. And he said the US has been held to unreasonable standards of proof.

We all know that the WTO has ruled against the United States in almost every case, big or small; and I can tell you that there is tremendous concern in this Congress about this unbelievable trade deficit, a trade deficit so big that if any of us had predicted it would be this size 10 years ago, or even 5 years ago, people would have felt we were crazy. And there is tremendous concern all across this country about jobs.

What I am getting at, everyone—all of—everyone in this country and even companies all across the world who favor free trade had better start doing whatever they can to encourage more fairness from the WTO toward the United States or there is going to be a tremendous backlash. It is already starting to develop; and even if Members of Congress don't want to, the American people will start demanding that we take actions.

So what I am saying is, your legal team had better start preparing a little better case or a stronger case than what has been presented to the WTO in the past, or something a little different, I guess, should be done.

You talked in your testimony about what you call the massive subsidies over the 35-year history. How much have those subsidies totaled? Have you been able to determine that?

Then, also, you mentioned that EU governments have forgiven Airbus—had forgiven a lot of Airbus's debt. How much debt has been forgiven?

Can you give us a rough idea on those, the total of those subsidies and that debt forgiveness?

Mr. ALLGEIER. Thank you. Thank you, Mr. Duncan.

With respect to your first comments, indeed, Chairman Thomas yesterday held a markup of a resolution, a joint resolution, which the Congress examines every 5 years, as to whether the United States should continue to participate in the WTO. There had been a subcommittee hearing, trade subcommittee hearing a week or so before on this subject; and, indeed, there was quite a bit of criticism by the subcommittee and some members of the committee with the dispute settlement process at the WTO.

Now, that said, the outcome of yesterday's markup was a unanimous vote to report that resolution out unfavorably, i.e., the resolution that we shouldn't participate.

Mr. DUNCAN. Everybody knows that we are not going to withdraw at this point.

Mr. ALLGEIER. Right. But if I could just get to the more specific point of the disputes and the track record there. Over the 10 years that we have been in the WTO, the balance between the cases we have won on the core issues and the cases we have lost on the core issues is 54 percent win. But that excludes some three dozen cases

which we—either we initiated or someone else initiated against us, where we negotiated a satisfactory settlement to the United States during the course of the litigation. So the result of that is that, in 71 percent of the cases, we have either won on the core issues or we have negotiated a satisfactory settlement.

I think what is even more relevant for this case here where we would be initiating a case is our track record of wins plus satisfactory settlements in cases that the U.S. has initiated against someone else is over 90 percent.

Mr. DUNCAN. If that is the case, why do you think there was so much criticism from the Ways and Means Committee yesterday and statements about the fact that WTO has been ruling against us so much—if that is true?

Mr. ALLGEIER. Well, because, I mean, there is concern with any time that we lose a case. In a number of these cases, members were particularly concerned because they had to do with some of our trade remedy laws. Although the kinds of losses we have had there have certainly not prevented us from very aggressively using or very—conscientiously using our trade remedy laws.

With respect to your question about the magnitude of the subsidies, if you look just at the launch aid itself, that particular form of subsidy that I mentioned, the subsidies to date by our calculation are over $15 billion; and if you add in the other forms of subsidization, it is certainly significantly higher than that.

With respect to your specific question on debt forgiveness, that I would have to get back to you, because I don't have that on my fingertips at this moment. But I will be happy to provide you with our best estimate of that.

Mr. DUNCAN. I see my red light is on, but let me ask you one last question.

You said the most egregious example was this $3.7 billion launch aid. Is that more than the 33 percent of the total development costs that was negotiated in that agreement in July of 1992?

Mr. ALLGEIER. The European Union claims that that $3.7 billion is within that 33 percent limit. That is just for that one model of the A380.

Mr. DUNCAN. All right. Thank you.

Mr. MICA. Mr. Larsen?

Mr. LARSEN. Thank you, Mr. Chairman.

Ambassador Allgeier, I have some questions for you, but you have answered largely most of them from questions from other folks. So I am going to give you a little rest if you don't mind, and I will ask Mr. Bogosian some questions.

With regards to the report the Commerce Department did, and I certainly want to commend the Department for not only doing their report but, obviously, for the conclusions and the research that went into it, and I believe the report is, indeed, part of the record. But I wanted you, if you could, to answer some questions for me and for the committee on the record about some fundamental conclusions on certain topic areas, if you could. Are you prepared to do that for us.

Okay. On military R&D, page 71, there is a discussion about military R&D applied to Boeing and Airbus and general aerospace manufacturing. Can you provide the committee verbally what the

fundamental conclusion about military R&D is relative to this issue of subsidy?

Mr. BOGOSIAN. Thank you, Mr. Larsen.

This goes to the prior question by I believe Ranking Member Costello in terms of the range of supports and Airbus's allegations that Boeing, in turn, receives certain types of supports, one of them being military R&D.

One of the things to keep in mind there is that, first of all, not all military R&D dollars go straight to the development of a Boeing product, which appears to be the allegation here from the other side.

The other thing to keep in mind is that even if you give them their entire argument, just hand it to them on a silver platter, what they are saying is that the military and space side of the Boeing company--that any R&D dollars that they receive somehow benefits the commercial side of Boeing. Well, then, you know, what is fair for one side must be fair for the other.

You look at Airbus; and Airbus's military side is its parents, EADS and BAE Systems. And if you look at EADS and BAE Systems just in 2003—we don't have the 2004 figures yet—in 2003, they received in military contracts $2.3 billion more than Boeing did.

So, by their own argument, they received $2.3 billion more indirect support—and I hate that term because it is just a smokescreen—so they receive more support, even if you give them their argument. But the bottom line is you can't give them their argument, because the argument has a fallacy right from the beginning. Not all military R&D dollars go to the development of the 737 or the 787 or whatever new model that Boeing puts out.

Mr. LARSEN. In fact, on page 73 of your report, it is noted, most defense R&D funding is mission-specific and earmarked for a higher level of development, testing and evaluation.

Mr. BOGOSIAN. One other thing to keep in mind is that Boeing is just one of the many U.S. Military contractors. EADS and BAE Systems are the top two largest European defense contractors. So you have got the two biggest, the two heavyweights making more money than just one of the many defense contractors in the U.S.

Mr. LARSEN. Moving on in that report, can you provide the committee verbally the fundamental conclusion with regards to civil R&D?

Mr. BOGOSIAN. Sure. There, again, it is yet another smokescreen. The problem is that you can't just look at NASA's and FAA's aeronautical R&D budgets and say, well, there you go, that somehow a truck is pulling up to NASA and FAA and then delivering the money from NASA and FAA to Boeing, and Boeing is using that money to build a new aircraft. That is just simply not the case. It is a ludicrous argument.

First of all, not all of NASA's and FAA's aeronautical R&D has a direct correlation to the development of a commercial product. So one thing you have got to do is take off the top anything that is an R&D expenditure that does not have a commercial application. You are left with a smaller sum.

From that, what you look at is which of those programs did Boeing participate in? And, which of those programs had a commercial

benefit? And of those—and this is key—there is a very crucial difference between how we give out R&Dmonies and how the Europeans do.

A lot of our R&D dollars are for the public good, which means that once you are at the end of the R&D process, you give out the results of that research for the public good. They are all shared. So Airbus gets it, Boeing gets it, and whoever else wants it gets it, and has access to it.

In Europe, however, those types of R&D dollars are very specific. They are much more aligned to a commercial objective. They are dedicated to a specific national champion, an industry that they pick and the technology that they pick that they want to advance. They are much more closely aligned to a commercial objective; and U.S. companies cannot participate in European R&D contracts the way that Europeans can participate in ours.

Mr. LARSEN. Mr. Chairman, if I may, just another question.

Can you provide the fundamental conclusion on infrastructure programs on page 79, 80? Provide the committee verbally your fundamental conclusion on infrastructure programs.

Mr. BOGOSIAN. Sure. Basically, the way you can look at this is that there is a real blurring of the line between where the European Government treasuries end and where Airbus's operating or research budget begins. So you can just tack on the infrastructure assistance as well on top of all the other things we have talked about.

I can list a few examples. The City of Hamburg, Germany, provided 751 million Euros, which is a sizable amount of money, to fill in a swamp.

There was an NGO group that opposed this environmental damage. They lost. So the 751 million Euros went ahead, and they filled in a swamp so that A380 could have a production facility in what was once the swamp.

French governments, federal, regional and municipal, have provided 182 million Euros to create the aeroconstellation site, which is another Airbus facility for the assembly of the A380. So, again, you just keep tacking on. You have the royalty based loans as launch aid, you have the debt forgiveness, you have the infusions of capital, the direct checks that are written, and then you have the infrastructure assistance. So it is just one thing after another after another, and for them to say that they are competing fairly against us is just a very difficult argument to accept.

Mr. LARSEN. Thank you; and, Mr. Chairman, thank you for an opportunity to ask some questions.

Again, this report that the U.S. Department of Commerce has put out through the International Trade Administration really does provide an effective background for all of us on the committee to get fully up to speed on the kind of case that we need to be making in the international arena when it comes to subsidies, and especially with this issue of launch aid which, again, I will emphasize, launch aid has to end. It has to end to create a fair and level playing field in the commercial manufacturing arena.

Mr. MICA. I thank the gentleman.

Mr. DeFazio.

Mr. DEFAZIO. Thank you, Mr. Chairman.

I have a concern in that, you know, we are hearing persistent reports that members of the EU intend to go ahead with launch aid on the 350. The way you outlined the dispute resolution mechanism, Ambassador, it seems to me that if tomorrow they announced launch aid and Airbus went ahead with development, they would be selling planes before it is likely that we would get a judgment, and then that would have already created yet another problem for Boeing.

So, I am curious what—and, obviously, you are not going to let out your strategy here, but if we have such an open-or-shut case, which the two of you say in terms of Boeing isn't subsidized—they are. It is pretty clear that this launch aid is a subsidy. Then why have we lost precious time? We had a 90-day agreement for delay, and we are past that now, and we haven't filed.

Isn't there—there is a prospect here that we could see yet another plane launched with subsidies that would hurt Boeing—and Boeing has chosen a different strategy and a different market with the 787, and we will find out in the end who is right. The EU has created the plane Godzilla, and now everybody who wants to have it land has to put out huge amounts of public funds just to reinforce runways, widen runways and create the facilities for it. So I am concerned about Boeing losing its competitive edge in this strategy that they have chosen in this interim period.

Mr. ALLGEIER. Certainly, we work very closely with Boeing and other U.S. interests here to determine what is most advantageous in terms of what is the best route to solve this problem, between the litigation, where you have a lengthy period, but we feel a very high probability of getting an important win.

By the way, I want to emphasize that if we move forward with this litigation that we would not just be seeking the elimination of launch aid going forward, we would be seeking the repayment of the launch aid that had been provided, whether for the A350 or the A380.

That said, we certainly don't want to be dithering about which course to take in a way that is going to be commercially disadvantageous to U.S. interests.

So when the new U.S. Trade Representative came into office, Ambassador Rob Portman—he was sworn in on a Friday. That Saturday night, he got on a plane to Europe; and that Monday, he met with Trade Commissioner Mandelson; and the first subject they discussed was this aircraft dispute. So he has gotten involved immediately to assess, in consultation with U.S. industry, what is the best way to proceed. He has had a number of discussions with Trade Commissioner Mandelson since then.

Let me just say that we are assessing this issue on basically a daily basis to determine what is the best way forward; and we will, as I said earlier, not dither at all about moving forward. And if that requires litigation or if that requires negotiation, we will take the course that we, our advisors in the industry think best.

Mr. DEFAZIO. Now, Boeing and its employees in the U.S. are potentially the principal injured party here, but obviously when I raised these issues more than a decade ago, the cross currents I got were, oh, my God, our customers buy Airbus and they buy Boeing.

Are you getting pushback from any of the U.S. Airlines, domestic interests that are involved with Airbus saying, you know, we don't want this? Is there any question that we are dedicated to resolving this issue of subsidies and particularly preventing subsidies for the A350? Is there any question at all?

Mr. ALLGEIER. There is no question at all about that, and I can certainly say personally I have not been even approached by interests such as airlines or others suggesting that we should take any other course.

Mr. DEFAZIO. That is good to hear.

Mr. Bogosian, there is an issue you touched on briefly—about the FAA significant resource challenges and the potential for losing sort of our regulatory and certification advantage. I guess, since you are with the Commerce Department and you are expressing that, do we have a little kind of cognitive dissonance within the administration where they are recommending these cuts which could be to the disadvantage of U.S. Industry and U.S. Carriers?

I have already heard previously from some of the smaller plane manufacturers that the European system is not equivalent to ours. That is, theoretically, we have equivalents. We provide documents showing that our planes have met our standards, which have historically been considered the gold standard; and you would think the EU would accept them. Well, they don't. They go through a lengthy review process to advantage their manufacturers, particularly if they have a model coming up that may compete. I heard this in particular from one small jet manufacturer. We are already kind of at a disadvantage because we play the game straight up.

They send over the paperwork. We say, yup, you did it right. Okay, you can start selling in the U.S.

We send it over there; and they say, oh, no, we might take a year or two to look at this.

So I am concerned that further delays or disadvantaging our domestic process is going to put our manufacturers at even more disadvantage. What plan do we have to deal with that?

Mr. BOGOSIAN. Thank you, Congressman DeFazio.

When we say this is a Commerce Department report, it was printed by us, and we managed the process. The FAA was a very key contributor and author in this report. Their views are fully represented, and this stands as a comprehensive document. It is a collaboration between Commerce and NASA and FAA and DOT and State and USTR and DHS, and you name them, they are all here. All their views are here for the Congress.

From our perspective, what we look at is the competitive side of these issues. We look at how the FAA handled their matters, the USTR handled their matters, and we do our job, which is to report to them. We give them data that relates to how industry is being unfairly disadvantaged and discriminated against, as well as an assessment of the industry's damage.

So when we look at the certification issues, we look at things like the hushkits example, a case where an environmental certification, which should just be done on a scientific basis, was actually done in a way that they looked at the specifications of a Rolls Royce engine and the specifications of a Pratt and Whitney hushkitted en-

gine, and they built their certification rules on the specs, not on the noise that was coming out of the engine.

Mr. DEFAZIO. Which would be WTO violative, as far as I know, the least restrictive way to comply.

Mr. BOGOSIAN. The harsh part there was, the fact that they did that led to people not buying the Pratt and Whitney hushkitted engines. So by the time they withdrew that regulation and said, oh, sorry our fault, Pratt and Whitney had already suffered the loss.

The same applies to safety certification. We don't want to see games being played. You can take an example where a 737 had to fly with four empty seats in France, and France only. And you ask yourself, well, if the 737 next generation can get a safety certification everywhere in the world but France, what is it about the French rules that don't allow the 737 to fly with those four people?

The coincidence there is that, without those four seats, the Boeing 737 next-generation model was much more compatible with its Airbus counterpart.

So those are the types of things that we look at. We look at it from the competitiveness side.

Mr. DEFAZIO. You are raising some excellent points. I would hope in the future that what we could do simply is just retaliate. If they want to do things like that, that is fine. Well, gee, the Airbus can't fly over Illinois with those seats occupied. You know, there is some reciprocity here.

Years ago, I remember Lee Iacocca saying, if we started to treat the Japanese, when they were moving into the van market, their vans, the same way, hold them on the docks for 3 to 6 months, like they did his, then pretty quickly his vans wouldn't sit on the docks for 3 to 6 months.

Somehow, you know, we play the game straight; they don't. We take it year after year.

There are two questions. What is our strategy to deal with that? And secondly, I was asking a question more specifically about budget cuts at the FAA which are going to further disadvantage U.S. manufacturers who want to get certified on the safety basis when the FAA will accept the EU safety certifications by just looking at the paperwork and saying, fine with us.

Since all those parts of the administration were involved, and you mentioned specifically the potential problems with FAA, with these budget cuts, again, I didn't get an answer to that. I realize maybe your minders are listening downtown, and you can't say that we need more money. So I will say it. We need more money. So I will answer that question.

But maybe you can go back to the first one. Are we looking at a retaliative strategy in the future, to say, okay, fine, if you want to do something like that, well, we are just going to do it over here, too, until you stop doing it, instead of letting them drive us out of the market like they did Pratt and Whitney?

Mr. BOGOSIAN. On the FAA question, I will get you an answer. I can't answer that myself. I will get you an answer from the FAA on the retaliation.

[The information follows:]

Rep DeFazio: . . . . "If a country uses the certification process to unfairly delay U.S. products coming to market, does the FAA have "a retaliative strategy for the future, to say, okay, fine, if you want to do something like that, well, we are just going to do it over here, too, until you stop doing it, instead of letting them drive us out of the market like they did Pratt and Whitney?"

The FAA does not employ a retaliatory strategy in response to trade issues concerning U.S. aeronautical products. Any issues affecting industry competitiveness are raised by the affected industry representatives to the Department of Commerce and other government agencies for resolution. The FAA procedures for type validation of imported aeronautical products are not impacted.

The process that the FAA uses for type validation of foreign aeronautical products is driven by international agreements. These agreements (in the form of bilateral airworthiness agreements and bilateral aviations safety agreements) are not trade agreements and thus do not address competitive factors. Rather, they are technical agreements concerning the performance of airworthiness certification functions in the signatory countries. These bilateral agreements facilitate cooperation between the FAA and its partner aviation authorities, and minimize duplicative certification activities related to the import and export of aeronautical products.

We also would like to take the opportunity to clarify any misunderstanding about FAA's review of EU safety certifications. It is not just a paperwork review. The FAA, in accordance with title 49 of the U.S. Code must make "findings" or determinations of compliance to U.S. airworthiness standards before issuing a design approval. The amount and depth of the FAA's investigation depends on a number of factors including, but not limited to, the complexity of the proposed design, FAA's familiarity with the proposed design features, service history of the product, and the results of a risk assessment or safety analysis. For complete aeronautical products, the FAA does not just look at paperwork, but is also involved in determining applicable airworthiness standards and the proposed methods of compliance, as well as witnessing various tests.

With the recent establishment of the European Aviation Safety Agency (EASA), the FAA is renegotiating its bilateral relationship. We recently established specific validation procedures that will govern the conduct of future validation programs. Incorporated in those procedures is a formal issue resolution process that may be used to focus attention and resolve any program delays.

Mr. BOGOSIAN. Peter, if you want to take that.

Mr. ALLGEIER. We certainly look to insist that we are treated fairly and in accordance with the obligations that the other country has. I think it is true that in the past, on these issues and on other issues, we have declined to play the same game when the game involves playing outside the rules.

I think we need to look at each case carefully—and we will—to determine what is the most effective way to get the other side's attention and to get the problem solved. So I appreciate your thoughts on this.

Mr. DEFAZIO. Mr. Rumsfeld might call it asymmetrical warfare. Thank you.

Mr. MICA. I thank the gentleman.

Does anyone have additional questions? If we have no additional questions now, we may have some additional questions we will submit from the subcommittee to you to respond to. We would appreciate that. I want to thank both of our witnesses in this panel for participating.

We have two votes right now. We will probably reconvene about 12:10, maybe 12:15 at the latest; and we will hear from our last and second panel of witnesses.

So, again, I want to thank both of our witnesses for being with us on this first panel. I excuse you at this time.

We will stand in recess until approximately 12:10, 12:15.

Mr. HAYES. Mr. Chairman.

Chairman MICA. Yes. I am sorry.

Mr. HAYES. With your permission, can I jump over this panel and speak to the other one? I am not sure how I am going to get back.

Mr. MICA. They are not up yet. If you wanted to make some comment or leave something on the record that we could try to get them to respond to, I would welcome that.

Mr. HAYES. Thank you, sir. I do appreciate that.

I appreciate the gentleman's testimony. Like Mr. DeFazio said, we have to stick it to them, as they have been sticking it to us. It is not called retaliation. It is called sticking up for our people and products.

I appreciate you all being here. We need to be tough, aggressive, competitive. We have got the best products. The market needs their products; and I hope the FAA, Mr. Chairman, will be as aggressive in the certification process making sure that our products get certified. Yeah, we will do the budget process and have the people there. But I want our FAA people to aggressively, insightfully pursue the opportunity to get our products to the marketplace.

Thank you again for the hearing.

Mr. MICA. I thank the gentleman and appreciate your comment. Again, we appreciate your participation.

We will stand in recess and then hear the second panel.

Mr. ALLGEIER. Thank you, Mr. Chairman.

[Recess.]

Mr. MICA. The next order of business is our second panel today, and this panel consists of three witnesses.

The first witness is Bryan T. Moss, who is President of Gulfstream Aerospace Corporation; Mr. John W. Douglass, President

and CEO of Aerospace Industries Association of America; and the third witness is Dr. Marc L. Busch, Associate Professor of Queen's College School of Business in Kingston, Ontario, Canada.

I would like to welcome our witnesses.

TESTIMONY OF BRYAN T. MOSS, PRESIDENT, GULFSTREAM AEROSPACE CORPORATION; JOHN W. DOUGLASS, PRESIDENT AND CEO, AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA; MARC L. BUSCH, ASSOCIATE PROFESSOR, QUEEN'S COLE GE SCHOOL OF BUSINESS, KINGSTON, ONTARIO, CANADA

Mr. MICA. I will first recognize Bryan T. Moss, president of Gulfstream Aerospace Corporation.

Welcome, sir. And you are recognized.

Mr. MOSS. Thank you, Mr. Chairman. Thank you, sir.

Mr. Chairman, it is indeed an honor for me to be here today on behalf of Gulfstream's more than 7,000 employees.

Mr. Chairman, you have my opening statement, which has been submitted to the subcommittee; and with your permission, sir, in the best interests of preserving time, I wish to summerize this opening statement.—

Mr. MICA. Without objection, your entire statement will be made part of the record. Please proceed.

Mr. MOSS. Thank you, sir.

Before I proceed, sir, let me, for the record, express my personal thanks and appreciation for the hard work you and the subcommittee have done on behalf of our industry, in particular for the efforts on the Reagan Airport issue.

To summarize the items in my opening statement, sir, first, we need FAA certification services that will allow us to bring new products into service in an increasingly competitive market.

Secondly, we are not supportive of user fees and increased excise taxes to cover the shortfall created by a declining general fund contribution.

Thirdly, further reductions in NASA's aeronautics research budget pose a direct threat to this country's ability to sustain a leadership position in aviation, with significant, negative impact on national security, safety and our economy.

Fourthly, and importantly, government subsidies to foreign aircraft manufacturers provide them significant competitive advantages and enable them to bring more new products to the market sooner at aggressive pricing and with little or no financial risk.

In short, Mr. Chairman, we cannot compete with national treasuries.

Finally, sir, in view of these issues and our concerns, I respectfully suggest we consider broadening the application of a new bilateral agreement and large civil aircraft to include all aircraft.

Thank you, sir, for the opportunity to be here to present these views. It is a privilege for us. And that concludes my remarks, sir.

Mr. MICA. Thank you.

Thank you. And we will now hear from Mr. John Douglas, President and CEO of Aerospace Industries Association. Welcome, and you are recognized sir.

Mr. DOUGLASS. Thank you, Mr. Chairman, and Mr. Costello and other members for the opportunity to join you here today in this important hearing today.

Sir, with your permission, I ask that my full statement be—

Mr. MICA. Without objection, so ordered. And please continue.

Mr. DOUGLASS. Mr. Chairman, my summary of my statement will focus on two critical areas of concern, launch aid provided to Airbus by European governments, and government-funded research and development on both sides of the Atlantic.

For fair trade to take place, Mr. Chairman, the jet transport industry must be an industry without government-provided launch aid, aid that is in direct violation of the WTO subsidy codes. With this in mind, AIA commends the U.S. Government on its decision to withdraw from the 1992 bilateral agreement on large civil aircraft. The 1992 agreement allowed for European governments to provide launch aid for large commercial aircraft as long as the total launch aid was equal to or less than 33 percent of the overall cost of development. Launch aid shields companies like Airbus from assuming complete commercial risk and allows producers to pursue more aggressive pricing and financing practices.

Since its inception in 1970, Airbus has benefited from a total of $15 billion in launch aid, including recently a $3 billion-plus loan for the new A-380. This was discussed in the first panel today.

U.S. Industry estimates that over the years this launch aid has allowed Airbus to keep a total of approximately $35 billion in debt off its books. Despite the ongoing negotiations outlined by the first panel, the problems involving Airbus and launch aid continue with Airbus' recent request for launch aid for its planned new A-350 aircraft.

I must say, Mr. Chairman, that with the granting of any launch aid for the A-350, AIA would support further WTO action by the administration.

For too long, European treasurers have shielded Airbus from the same market risks that American commercial competitors face. At the time of the 1992 agreement's implementation, Airbus was a company with four product lines, 38,000 employees, and 8.8 billion in annual revenue. Today, Airbus has 12 product lines, 51,000 employees and more than $25 billion in annual revenue.

By 2004, Airbus was delivering more aircraft per year, producing more products and had a higher revenue than its main competitor, Boeing Commercial Airplanes.

Industry's position on these issues has remained consistent. We want to avoid a trade war, we want to see a negotiated settlement with EU as soon as possible, and we want to ensure a level playing field for the civil aircraft market, not one encumbered by European launch aid.

Mr. Chairman, the Boeing-Airbus dispute is not the only cause for concern to our industry. The European Union, through its plan, ″A Vision for 2020,″ has clearly stated their intention to dominate the world aviation market. As a means to that end, the Europeans have begun to invest heavily in a coordinated and targeted aeronautics research and development program. From the start of $45 million in 1990, the EU has dramatically ramped up funding for aeronautics to more than 1.52 billion on aeronautics research be-

tween 2002 and 2006. It is safe to say that the state of aeronautic research in the U.S. Is not as well off as it is in Europe.

Over the last 10 years, funding for NASA's aeronautics research has been cut nearly in half. NASA's recent lack of attention to basic seed corn research will impair the U.S. Industry's future ability to compete in the global aerospace market.

The U.S. Must renew its commitment to aeronautics research, establish a national policy for aeronautics, and provide the necessary funding to undertake needed research.

In summary, Mr. Chairman, it is in neither the interest of the United States nor the European Union to have a trade war that would damage the global aerospace industry and undermine economies across the globe. Officials on both sides of the Atlantic should build a consensus on replacing the 1992 bilateral agreement in a way that makes the civil aircraft market more competitive and averts a potentially long and acrimonious dispute in the WTO.

A newly negotiated agreement must level a competitive playing field before large aircraft manufacturers—indeed, aircraft manufacturers in general—and should include a prohibition against government launch aid subsidies in accordance with the subsidy code of the WTO.

In 2004, Boeing delivered 285 aircraft, Airbus delivered 320. In the same year, Boeing announced 272 orders, as compared with Airbus' 370 orders. Boeing's backlog is now nearly 30 percent less than Airbus'. The playing field is essentially level in every possible measure, with the exception of government aid. Airbus should not be allowed to flourish under the protective cloak and open treasuries of European governments. The time to end this launch aid is now.

And Mr. Chairman, I look forward to answering any questions you may have, sir.

Mr. MICA. Thank you.

And I will hold the questions until we have heard from Dr. Marc Busch, Associate Professor of Queens University, School of Business, Kingston, Ontario, Canada. Welcome, sir, and you are recognized.

Mr. BUSCH. Thank you, Chairman Mica, Ranking Member, Costello, thank you for this invitation to appear before this subcommittee to discuss global market factors affecting the U.S. Jet transport industry. I applaud the subcommittee's leadership in examining this important topic.

In the late 1980s, when the Boeing-Airbus dispute was splashing across headlines, then-USTR Ambassador Michael Smith warned the House subcommittee that, ″decisions about launch aid and things like that should not be taken lightly, either by the governments involved or the industries involved.″

Today, on the eve of WTO litigation, his words are no less relevant. Indeed, launch aid ″and things like that″ continue to be a considerable source of tension in the industry, specifically with the 787 destined to go head-to-head with Airbus' A-350.

As was true in the late 1980s, the U.S. charges that Europe receives direct subsidies, and Europe countercharges that the United States offers indirect subsidies to its national champion. Is this, as Yogi Berra might have put it, ″like deja vu all over again?″

Some things about this commercial rivalry have not changed. The industry is still a catalyst of economic growth and competitiveness, not only because of the vast number of high-paying jobs, but because of the technological spillovers exhibited by this industry for those who benefit from them upstream, in particular. It is also, of course, as has already been pointed out this morning, an industry with remarkable export prowess.

Other things about this commercial rivalry, however, have changed. There are two notable differences between today and the tensions that gave rise to the 1992 bilateral: first, the rise of the regional jet market; and second, the advent of the World Trade Organization.

First, the regional jet market, which is dominated by Canada's Bombardier and Brazil's Embraer, is increasingly vying for orders with both Boeing and Airbus. As the Department of Commerce's study explains, Embraer is, ″starting to blur the traditional line between large civil aircraft and regional jets,″ going above 100 seats in particular, a move Bombardier is now seeking to match.

Thus, while a lot of attention has been paid to the flight test of the enormous A-380, the fact is that the smaller airplanes that are being launched by these two vendors are increasingly putting both Airbus and Boeing to the test, a point made very clear in Boeing's Current Market Outlook 2004.

More worrisome, though, is the fact that at times, through the past couple of decades, these two competitors have been subsidized, posing a new competitor threat to both Airbus and Boeing. In short, subsidized competition in civil aircraft is a much more widespread problem today than it was on the eve of the 1992 bilateral.

Second, and related to this, the WTO for its part is a much more viable forum in which to litigate this dispute this time around. This is because, as has already been pointed out this morning, the WTO's subsidies code is much more vigorous and the dispute settlement mechanism is much more robust. In the early 1990s, when the U.S. and the European Union readied to go to the GATT to fight this dispute, the fact was that the relevant disciplines and the dispute settling mechanism were not up to the task. That is no longer true. Particularly, there is no longer any potential for a losing side to block the adoption of a panel report, or for that matter, to stand in the way of authorization to retaliate, one of the brand-new features of the WTO mechanism. Taken together, the regional jet market and the WTO, it is perhaps time now to finally litigate this dispute and to do so with a little more determination.

The WTO has historically worked, as the Ambassador pointed out this morning, by inducing early settlement. That means that, by and large, both parties to a dispute settle before the case is even paneled, never mind before a panel issues a ruling. To date, that has not happened in the civil aircraft dispute; consultations were not successful, nor has the cease-fire been. That is okay, because perhaps it is really important for us to get this one litigated once and for all, and to do so with a couple of factors in mind.

First, there are some things to learn from the Canada-Brazil disputes that have gone to the WTO. To date, both sides have challenged each other's subsidy schemes, and both sides have chalked up some victories. And these victories have served to do two things.

They brought clarity to the law, in that they have helped us understand what the WTO finds legal and not, and in fact, they have had bottom-line outcomes. For example, Bombardier has witnessed two subsidy schemes, that Brazil has benefited from, essentially eliminated; and a third, called PROEX III, essentially handicapped. For its part, Brazil has one big notable victory against Canada and a couple of failures.

We can learn a lot from these disputes. And these disputes remind us that while the WTO is itself not an answer in all cases, in civil aircraft it may be very viable not only because of the legal clarity that we will get but because, as in the case of Canada and Brazil, it has forced both sides to return to the negotiating table to find a long-term robust solution for this dispute.

Let me conclude by suggesting that WTO litigation in the current Boeing-Airbus dispute will serve three purposes. First, as I have said, it will bring legal clarity to what has become a very politically charged and heated dispute. It is time for the WTO to render verdicts on these charges and countercharges and to help us move forward.

Second, the litigation will not only implicate the United States and the European Union, it will implicate Canada and Brazil as well. With the regional jet market now essentially melding into the large civil aircraft market, it is time to bring disciplines to subsidies across the board and to level the entire playing field.

And third, as I mentioned, WTO litigation will likely prod both the United States and Europe, with greater legal clarity, to return to the negotiating table, but this time we must return to the negotiating table with all four parties: the U.S. and Europe, Canada and Brazil. It is time to bring sanity to this industry across the board.

To its credit, the 1992 bilateral agreement foresaw the need to multilateralize these provisions. It foresaw the time when it would be crucial to multilateralize subsidy disciplines in civil aircraft.

Today it is no longer visionary to say that; it is simply a fact. It is time to get this industry on a level playing field, but to realize the industry has changed. Thank you very much.

Mr. MICA. Well, thank you.

And I thank all of our witnesses and this panel for their testimony. I have a few questions.

Mr. Moss, you just heard Dr. Busch talk about RJ Production producing smaller aircraft that compete with some of the product that you have; is this a problem?

Mr. MOSS. Sir, it is not so much the RJ as it is the rest of the Bombardier product line. Across the entire product line, they benefit from exactly the type of assistance and subsidy that Dr. Busch is referring to. We do not at this point in time compete directly with the RJ or with the RJ derivatives, but it is a huge issue for us simply on a day-in/day-out basis, facing these aircraft in the marketplace.

Mr. MICA. We have produced no RJs in the United States at this time, right? I guess you have produced probably the largest passenger aircraft of a smaller size?

Mr. MOSS. Yes, sir. The largest business and corporate aircraft of its kind.

Mr. MICA. I have read recently where—I think it was Bombardier just announced that they are going to provide some subsidies for production of smaller aircraft and competing aircraft. Anyone aware of—I read that most recently.

Dr. Busch.

Mr. BUSCH. Yes. Bombardier has sought to secure assistance both from the Federal Government of Canada as well as from the Province of Quebec.

Mr. MICA. And was some of that in the form of loans for development product?

Mr. BUSCH. Yes, I believe it is.

Mr. MICA. How much Federal subsidization of financing are you getting, Mr. Moss? Come clean.

Mr. MOSS. That is easy, sir. None.

Mr. MICA. Oh, okay. All right. Thank you.

You advocated also a new international agreement to include all aircraft. Certainly we would want to put some pretty tight restrictions on any type of aid or assistance. How would you craft that?

And I think we also heard Dr. Busch say that we need to include other participants, such as Brazil and Canada. Would you agree with that, and how would you craft it, Mr. Moss?

Mr. MOSS. Well, my experience, sir, we see daily the impact of the subsidy issue in the marketplace. Dr. Busch and I have not discussed that issue, but I must agree with the premise that he has put forward that any opportunity for a meaningful, long-lasting resolution of that issue must involve those parties who are involved on an everyday basis, so those would be U.S., Europe, Canada, and Brazil.

Mr. MICA. As we lose more market share, Mr. Douglass, what is the effect you are seeing on overall viability of America's aerospace industry?

Mr. DOUGLASS. Well, clearly the commercial aviation market is about 50 percent of our sales, Mr. Chairman. And so when we lose global market share, it has an impact across the board in terms of the number of people that are engaged in the industry, our ability to fill new products, and our overall viability as an industry.

Mr. MICA. I have watched us lose a number of industries in the United States in commercial activities. You get sort of this belief that some product is added in the United States or some product is added to a foreign product where it is assembled someplace else, and that is a reason to back off. What do you think about that, Mr. Moss, Mr. Douglas, Dr. Busch?

Mr. MOSS. Well, sir, may I? In a former life I worked with an offshore—or a foreign company. I am very familiar with the thought processes that lead to trying to determine whether or not you are a product from north of the border or south of the border. And I plead guilty to a certain personal view, sir, but I believe that the country of origin of manufacture is what is critical, not so much where the components come from that are in that aircraft.

Mr. MICA. Mr. Douglass.

Mr. DOUGLASS. Well, sir, as you know, this is what makes this problem so complicated. In regards to the issues between us and Europe, for example, we are Europe's biggest customer and Europe is our biggest customer. Most of the European products have some-

where between 30 and 50 percent of the American content. Many of the other airplanes manufactured in Brazil and Canada also have high degrees of American content. So when you get into one of these complicated issues like we are discussing this morning, you have business interests here in the United States essentially on both sides of that issue, and that does complicate the issue.

I think what is really important is what was said by the first panel, and that is that when a case gets to the point where both the government and the industry agree that the international situation warrants taking a case to the WTO, you have reached a point where it has become super-critical. And we support what the administration is doing in the case of the Boeing-Airbus dispute, despite the fact that we obviously sell a lot of product to Airbus.

Mr. MICA. Dr. Busch.

Mr. BUSCH. Well, I concur with Mr. Douglass' points. The crucial issue is really when you begin to lose some of the more complicated high value-added manufacturing, notably the systems integration work and the like, which not only employs, as has been pointed out, people at high wages, but moreover teaches us through learning-by-doing, to go on and truly enjoy market share in other upstream industries by virtue of having mastered those technologies.

Mr. MICA. I thank you all for your responses. Let me turn to Mr. Costello.

Mr. COSTELLO. Mr. Chairman, thank you.

Mr. Moss, let me ask you first, and then Mr. Douglas and Dr. Busch as well.

I serve on the Science Committee as well, and we have been attempting to convince the administration to increase, not cut, the R&D budget of NASA as far as the aerospace industry is concerned. And I wondered, if just for the record, if each of you, beginning with Mr. Moss, if you would comment on the effects of the declining research budget for NASA. I made a reference to the figures in my opening statement from a high in 1994, I believe it was, fiscal year 1994, almost 1.6 billion, down to now about half of that for fiscal year 2006 is what the President is proposing. And I wondered if you might comment on what the declining R&D has done and will continue to do if we continue to see a reduction in NASA's R&D budget.

Mr. MOSS. Yes, sir. I think from a broad standpoint it is a threat to the leadership that this country has enjoyed for a long period of time. The areas that are of interest to us—there are areas that involve safety, security, productivity, et cetera. And by and large they are areas that we could not afford to pursue on our own.

The ability to have NASA involved in that type of project is extremely important to us, as much as an industry benefit as just a Gulfstream benefit, because in many cases the results of efforts in that area are available to a wide spectrum of constituents.

Mr. MICA. Mr. Douglass.

Mr. DOUGLASS. Yes, sir. That is a great question, sir. I guess the place to begin is to say that the erosion that you spoke about in your statement is going to be a problem for us for years to come because you can't just overcome this overnight. We have got to start overcoming it today. The basic seed corn that NASA puts into aeronautic funding supports a whole broad area of not only support

to our commercial aviation and business aviation market, but also to our national security.

I think I have testified before this committee on other occasions and the personal experiences I have had where NASA's aeronautics research pulled the bacon out from me when I was Assistant Secretary of the Navy when we had problems on the F-18.

So there is no quick fix to this. I am heightened by the fact that Representative Wolf has agreed that we are not going to accept the administration's cut this year, and at least we are going to restore the budget back to where it was last year. It is going to take us some time to rebuild this; there is a lot of rebuilding to do. Some of the areas where we have to immediately begin to pay some attention to is turbine engine technology and rotorcraft technology.

I took a briefing yesterday, and that briefing will be given to my board meeting tomorrow down in Williamsburg about the number of rotorcraft that we have lost in the war on terror. It is an alarmingly high number. And when you look at the root cause for that, it ultimately takes you back to the fact that we haven't made much investment into rotorcraft research and development over the last 15 years. NASA has backed away from their joint program with the Department of Defense. So, sir, we are in complete agreement with you that this is a national strategy and national policy that needs to be put in place and needs to be rebuilt if we are going to maintain the $30 billion-plus positive trade surplus that our economy enjoys from this aerospace marketplace.

Mr. COSTELLO. Dr. Busch, do you care to comment?

Mr. BUSCH. Only to note that to increase NASA subsidies is not necessarily to run afoul of trade rules. The remarkable thing about NASA subsidies through the years is that, for example, the Japanese are largely argued to have learned composite materials from NASA R&D. And for that matter, Airbus has tested a lot of designs in NASA facilities. So it is important to not be deterred by virtue of certain of the allegations made in the current dispute, that anything through NASA is necessarily an illegal subsidy.

Mr. COSTELLO. Mr. Chairman, I have no further questions, but I do want to encourage our—first of all, thank the panelists for being here. And secondly, encourage you to weigh into the administration as to the importance of trying to increase the R&D budget for NASA. Thank you.

Mr. MICA. The gentleman is recognized, Mr. Larsen.

Mr. LARSEN. Thank you, Mr. Chairman.

Mr. Douglass, both Dr. Busch and Mr. Moss talked about including Canada and Brazil in a new type of agreement. What does the organization have to say about that proposal?

Mr. DOUGLASS. You know, when you listen to the first panel and you listen to our Trade Rep talk, he went into some length to explain that the key ingredient of bringing forward a trade case was liaison between administration; in this case the Trade Representative and certain segments of the industry.

Right now the focus of the Trade Rep's attention has been placed on the large aircraft arena. We have heard testimony this morning from Mr. Moss and others that the other parts of the civil aviation marketplace feel that their sector of the market is also disadvan-

taged by these European subsidies, and indeed, by subsidies that you mention from Canada and Brazil.

The next step in the process would be for those portions of our industry to engage with our Trade Rep to make the determination whether or not it is in our national interest to enter into an additional dispute that goes beyond the Boeing-Airbus dispute today. But until that full liaison step has been taken, I would be reluctant, sir, to bring that into this current dispute. I think for now we need to solve the large aircraft dispute, but I certainly believe that if the rest of our industry feels that they are at a disadvantage, too, our Trade Reps need to listen to them and then determine what that next step would be.

Mr. LARSEN. Thank you. Could you comment a little bit on your testimony, Mr. Douglass, about the International Civil Aviation Organization and its role in—its role in some of these proceedings on competitive advantage on the lap of a U.S. Appointment?

Mr. DOUGLASS. Yes, sir. Mr. Chairman, what the Congressman is referring to is the fact that up in the International Civil Aviation Organization, the United States gets one vote, the European individual countries each get a vote, and they always vote as a bloc. So on any particular issue that might involve trade or something where we might have a national interest, they might have a national interest, we are outgunned, I don't know, 25 or 30 to 1 before we even open the subject. That is a structural problem that needs to be resolved.

Secondly, the current U.S. Ambassadorship to ICAO is vacant. The industry has endorsed a candidate. We would strongly encourage the administration to move forward on that position and appoint that candidate as the U.S. Ambassador to ICAO.

Mr. LARSEN. Thank you.

Dr. Busch, you talk about a multilateral approach, but let's focus on the bilateral approach right now.

We heard testimony earlier about what steps would have to take place. What steps do you recommend the USTR take from this point forward? Just keep in mind the bilateral approach.

Mr. BUSCH. Well, just to comment on Mr. Douglass' point, I am not suggesting that Canada and Brazil be directly targeted through WTO litigation on this point. Rather, I am talking about what Ambassador Allgeier points out earlier, which is that when we finally turn to try to negotiate a robust resolution, it must include two additional seats at the table. That can happen after a WTO verdict is rendered in the bilateral dispute, or it can happen before a ruling is issued in this dispute. Either way, what will happen now is the United States is likely to pull the trigger on a panel request.

Interestingly enough, it is quite common at the WTO for two parties to settle essentially out of court at the panel stage but before ruling is issued. If the case ultimately is ruled one way or another, obviously it is a little bit more difficult to begin to negotiate, but hopefully after we have cleared some hurdles. And Ambassador Allgeier points out that there are a couple of additional steps in the dispute settlement process. For example, a U.S. Victory would invariably be appealed. Once appealed, the United States and Europe may find themselves before a compliance panel, which would be the original panel asked to see whether Europe had done anything to

bring its measures into accordance with WTO obligations. If in fact nothing had been done, the United States could then proceed to ask for authorization to retaliate. This case could, as Ambassador Allgeier pointed out, go on easily for 2 years beyond the panel request.

Those are the steps that will happen most likely. This dispute has very few of the markings of a case that would settle early. And as I tried to suggest in my testimony, we may be at a point where it would be tremendously valuable to have this go the legal distance, to again have the WTO actually come down one way or the other on the charges and countercharges that, as I said, we have been listening to now for well over a decade.

Mr. LARSEN. I want to be specific about this question. I am not asking what you hope or we hope, but what would you expect would be a result? And what would you expect to be accomplished from further pursuit through this current process?

When I say that, I know what I hope the answer would be, but I am asking you, as somebody who spent some time thinking about these issues, what would you expect to be accomplished?

Mr. BUSCH. I would like to see the WTO render a verdict, as I said, on the charges and countercharges. My deep suspicion is that ultimately no legal verdict will bring an end to the dispute in total, that ultimately we will have to have negotiations. There the question will be: Is there anything shy of zero launch aid that is tolerable on the U.S. Side? The question bears asking by virtue of the fact that the 1992 bilateral set an informal benchmark against which any future deal might be assessed, both by those in political office and by those in the media. It is a salient focal point; it is a salient focal point for future negotiations.

Undoubtedly, there will be a request that whatever compromise be had on launch aid, the Europeans will undoubtedly think that number should be shy of zero. If the United States is not of a similar mind, then I think we have a problem. Which is why, again, going to the WTO and having decisions rendered on certain of these charges and countercharges will help clear the air and get us to start thinking about where the comprises are, and ultimately what our reservation point for, as Ambassador Allgeier pointed out, a good deal, not just any deal.

Mr. LARSEN. Sure. Mr. Douglass and Mr. Moss, any comments?

Mr. DOUGLASS. The only thing that I would say is we expect the outcome to be a prohibition against launch aid in total. And you may recall, sir, that—I don't remember whether this was mentioned in the first panel or not, but if you go back to the original 1992 agreement, the agreement spoke of a gradual phasing out of launch aid and taking it down to zero. That is one of the reasons why our Nation withdrew from the agreement, because they felt the Europeans stayed at 33 percent and wouldn't move towards zero. So the national goal is clearly to move towards zero.

Mr. LARSEN. You may recall from my opening statement that launch aid was one of the themes.

Mr. MOSS. From our perspective, any delay in dealing with the issue will have an impact on us. Time is not on our side, it is on the side of others, so it simply means we will have to continue to

deal with this imperfectmarket and the benefits they get through subsidies through some period of time, sir.

Mr. LARSEN. Thank you.

Thank you, Mr. Chairman.

Mr. MICA. Thank you. Are there additional questions?

Just a couple of points here.

Mr. Douglass, if you underwrite the research and development of a new aviation product or commercial aircraft, then you underwrite the financing, and then you underwrite some of the promotion, and then—well, I won't get into the bribes part we heard about, but what are the chances for our American manufacturers to compete?

Mr. DOUGLASS. Sir, it really only leaves us one area to compete in, and that is technology. And as you know, we have heard—all of the witnesses agree that the difference in the way we deal with unclassified technology here in the United States is we do most of our civil aviation technology through NASA, and then it becomes available to all concerned. Whereas over in Europe, their research and development is very targeted, and it is restricted to the companies involved in the research and development.

So, for example, we will be doing open research on flight controls or fluid dynamics or combustion at extremely high speeds. This is very basic research which helps you build products. On the European side, they have a tendency more to actually help a company take their product all the way to the marketplace.

And so even in our final area where we have had a traditional advantage, which is a higher level of technology in general in our aerospace market, it will become increasingly difficult for us to compete unless we see a national willingness to invest in aeronautics research.

Mr. MICA. I am wondering, maybe your Association could provide us for the record some information on—some hard information on—I guess during the build-up of this, America's space industry—and also the build-up of the military, I guess, during the Reagan administration—you had both defense and NASA being very heavily involved in R&D, and also developing systems or technology improvements that might be of benefit to the industry.

However, since basically the downfall of the Soviet Union in the early 1990s, you have seen us dismantling our efforts to really aid our defense industry in R&D and the dramatic fashion we saw previously. And then you have seen a decline in interest in activity, in us promoting R&D in space technology. If you have any figures of that pattern, I would like to submit them for the record. And then also, any evidence of increase from the European Union.

And I guess their national defense budget is just a few percent points of their entire national budgets. We ended up picking up most of the tab for defense, but I would be interested to see how they compare an increasing—and if you could target the dollars as you have seen going towards R&D, I would like to have that for the record if you could supply it to the subcommittee.

Mr. DOUGLASS. Yes, sir. We would be glad to do that. There are some interesting trends.

There is another trend that I would remind you of, sir, and that is a couple of years ago I was one of President Bush's commissioners on a commission that looked at the future of the industry.

And one of the things that became very clear to us—and this was a bipartisan commission, it was half of the members came from Congress and half from the administration—was that military research and commercial aviation research in recent years have sharply taken different courses. Military has spent most of its money moving away from platforms towards network centric warfare. The few things that they have done on platforms, like stealth, have very little application in the commercial marketplace.

And we have also seen institutional barriers arise that essentially prove that this argument that Boeing gets some great windfall from its defense contract is just not true, because technology is not flowing across those boundaries. Indeed, under your leadership, Mr. Chairman, we have established the Joint Development and Planning Office for our next air traffic control system because we would like to go back and get some of that DoD technology, not to help Boeing, but to help the FAA develop the new air traffic control system in the future. So we do have some statistics, sir, and we will try to respond to your request.

Mr. MICA. Well, I think that concludes my questions. We may have additional questions we will submit to you for response and inclusion in the final record of this hearing.

So we do thank each of you for your participation, for your patience in staying, even though your panel was delayed by votes, and look forward to working with you as we look to resolve some of the problems that have been highlighted by this hearing.

There being no further business before the Aviation Subcommittee, this hearing is adjourned. Thank you.

[Whereupon, at 1:00 p.m., the subcommittee was adjourned.]

Statement of
Ambassador Peter F. Allgeier
Deputy United States Trade Representative
before the
Committee on Transportation & Infrastructure
Subcommittee on Aviation
United States House of Representatives
Washington, D.C.
May 25, 2005

Chairman Mica, Mr. Costello, and Members of the Subcommittee, I am pleased to have the opportunity to appear before you today to testify on the U.S. jet transport industry and global market factors and policies affecting U.S. producers. I am going to focus today on a particular global factor affecting U.S. producers – subsidies for the development and production of large civil aircraft – and on the Administration's ongoing efforts to end subsidies to the European aircraft manufacturer, Airbus.

I will begin today with some historical background on the subsidy issue and on past U.S. efforts to address EU aircraft subsidies. I will then discuss developments over the past year, as the Administration, in close cooperation with the U.S. industry, intensified its efforts to end the subsidization of Airbus. I will then turn to the current situation and our plans for going forward.

The Subsidization of Airbus

Mr. Chairman, Airbus was established in 1970 as a European consortium of French, German, and later, Spanish and U.K. companies. It formally became a single integrated company in 2001. Airbus is 20 percent owned by BAE Systems of the U.K., and 80 percent owned by the European Aeronautic Defence and Space Company ("EADS"). EADS itself is 15 percent owned by the French State, and 5 percent owned by Spain.

Over its 35-year history, Airbus has benefited from massive amounts of EU Member State and EU subsidies that have enabled the company to create a full product line of aircraft and gain more than a 50 percent share of large civil aircraft ("LCA") sales. Every major Airbus aircraft

model was financed, in whole or in part, with government subsidies taking the form of "launch aid" – financing with no or low rates of interest, and repayment tied to, and entirely dependent on, sales of the financed aircraft. If sales of a particular model are below an agreed number, Airbus does not have to repay the financing. EU governments have forgiven Airbus debt; provided equity infusions; provided dedicated infrastructure support; and provided substantial amounts of research and development funds benefiting civil aircraft projects.

Since 1985, the United States has been involved in several rounds of negotiations with the Airbus partner governments and the European Commission, with the objective of achieving greater disciplines over the subsidies provided to Airbus. In 1989 and 1991 the United States brought two cases at the GATT challenging Airbus subsidies. The first case challenged a German program that offset adverse exchange rate fluctuations on sales of Airbus aircraft, and the second, broader case challenged overall subsidies to Airbus. The first case ended in a victory for the United States after a GATT panel determined that the exchange rate scheme constituted a prohibited export subsidy. The EU blocked adoption of the panel report, which was permitted before the creation of the WTO, but Germany subsequently withdrew the scheme.

The United States withdrew the second case in July 1992 after the two sides negotiated a bilateral agreement limiting government support for large civil aircraft programs. The agreement included a prohibition of future production support and a limitation on the share of government support for the development of new aircraft programs to 33 percent of a project's total development costs.

Three years later, the WTO Subsidies Agreement entered into force. The agreement applies in full to subsidies for large civil aircraft. Therefore, if a Member provides a subsidy that is inconsistent with the agreement's terms, it is subject to challenge at the WTO.

Despite these obligations, the EU has continued to subsidize Airbus. The $3.7 billion in launch aid that EU governments committed for the Airbus A380 "super jumbo" was the largest amount of funds committed for a single project. The EU provided further loans and infrastructure that

pushed the total amount of A380 subsidies to approximately $6.5 billion. Airbus is on the verge of launching another new aircraft, the A350, and it has requested $1.7 billion in risk-free launch aid for that aircraft as well, even though it has stated publicly that it could "easily" finance the project itself. Of course, even if it could easily finance the project, a risk-free advance of $1.7 billion provides a very significant competitive advantage over Boeing, its U.S. competitor, which has to bear the risk of launching new models without the support of the U.S. Treasury.

Efforts to Negotiate a New Bilateral Agreement

Mr. Chairman, our current effort to end the subsidization of Airbus began early last year, when it became apparent that EU Member States were considering subsidies for the A350. U.S. and EU officials had extensive conversations in the late spring and early summer, and two sets of meetings in July and then again in September, as the United States sought an EU agreement to negotiate an end to subsidies. President Bush instructed USTR to pursue all options to end the subsidization of Airbus, including the filing of a WTO case, if need be. The U.S. industry fully supported this approach.

Unfortunately, the EU was not willing to agree to the goal of ending new subsidies, much less on how to achieve this goal. Therefore, on October 6, 2004, we initiated the first stage of dispute settlement proceedings at the WTO by requesting consultations with the EU. The EU responded by requesting consultations on alleged U.S. subsidies to Boeing. We also exercised our right to terminate the 1992 Agreement at that time.

Although we held WTO consultations with the EU in November, we were unable to resolve our concerns. Then, on January 11, 2005, when we were on the verge of moving to the next stage of our WTO challenge, we reached agreement with the EU on a framework for negotiating an end to subsidies. We agreed with the EU to set a 90-day time frame for the negotiations. The agreement included a common goal of <u>ending</u> subsidies, as defined by the WTO Subsidies Agreement. The agreement applied equally to the United States and the EU. We appreciate the

support of the U.S. industry and the Congress during that period of negotiation.

In March, EU officials introduced a new set of conditions for the negotiations and backed away from the agreed objective of ending subsidies. They appear to have changed their position because certain EU Member States want to continue providing launch aid subsidies to Airbus, in particular for the Airbus A350.

The EU argues that it needs to continue providing launch aid to offset subsidies that Boeing allegedly receives from NASA and the Department of Defense. There is no basis for the EU's claim. We don't agree that NASA and Defense contracts provide subsidies to Boeing. But in any event, Airbus and its parents, EADS and BAE Systems, have space and defense businesses that rival Boeing's. Therefore, even under the EU's unfounded approach, Airbus benefits as much if not more than Boeing.

In addition, while the EU criticizes Boeing for receiving U.S. defense contracts, BAE Systems is one of the Defense Department's top ten contractors. It is involved in billions of dollars worth of Pentagon contracts, including the Joint Strike Fighter. EADS is currently seeking incentives from U.S. states to locate a new aerial refueling tanker facility in the United States. It plans to manufacture the tankers by converting Airbus large civil aircraft, the development of which, of course, has been subsidized.

Furthermore, Airbus has received billions of euros in subsidies from the EU Member States for infrastructure and for civil aerospace R&D. For example, when Airbus Germany needed to expand its production facilities for the Airbus A380, the Hamburg government spent 750 million euros to fill in a protected wetland. Similarly, the French government spent 180 million euros to create an aerospace industrial park where Airbus is assembling the A380. The European Investment Bank also underwrites Airbus's programs, including a 700 million euro loan to EADS to help underwrite the costs of developing the A380.

Meanwhile, the European Commission R&D "Framework" programs are devoting ever increasing amounts of funds to aerospace R&D. The European Commission "Sixth Framework" program alone granted 1.1 billion euros to aerospace projects. The research programs at the EC level are also supplemented by R&D programs at the national level that provide even more funds to Airbus. Unlike in the United States, the EC research often takes the form of direct cash grants to Airbus, and it focuses on projects with outcomes that can be applied commercially to products in the near- and medium-term.

It is clear that Airbus and Boeing are both active players in the defense and space markets, and that both companies receive contracts for R&D. But only Airbus receives launch aid. There is no similar type of financing available in the United States.

Launch aid is a particularly distortive type of subsidy because it shifts the enormous up-front expense and commercial risk of developing new aircraft from Airbus to European taxpayers. EU governments help underwrite new Airbus aircraft programs, and if Airbus guesses wrong about the market for a particular aircraft, it does not need to repay the money.

Moreover, because repayment is tied to sales, Airbus receives a substantial grace period before it needs to begin repayment. For example, Airbus has not even begun repaying the $3.7 billion that it received for the A380. Nevertheless, EU governments are preparing to give it even more money for the A350.

Launch aid also frees up funds that Airbus would normally need to invest in developing its new aircraft programs so that it can use the money for other purposes. For example, in March, at the same time that Airbus was asking for $1.7 billion in launch aid for developing the A350, its parent company BAE Systems spent $4 billion to purchase the U.S. manufacturer of the Bradley Fighting Vehicle.

The EU's continuing use of launch aid is also spawning imitators. On May 13th, the Canadian

government announced that the Federal government and the Province of Quebec would provide launch aid to the Canadian firm Bombardier to help underwrite the costs of developing its new "C-Series" aircraft. Interestingly, the UK government also announced that it would provide launch aid to underwrite the Bombardier project. All told, these governments have committed $700 million to Bombardier. With 110-135 seats, the proposed Bombardier aircraft will compete directly with Boeing and Airbus aircraft for the first time.

Current U.S. Efforts to End Subsidies

Mr. Chairman, the Administration continues to believe that a negotiated outcome that ends launch aid and other WTO-incompatible subsidies would be the preferred route for resolving this matter. But let me be clear. If we conclude that a negotiated solution to end subsidies is not possible in the near term, we will return promptly to the WTO. We believe we have a very strong case, and we are prepared to move forward. The Administration is committed to ending the subsidization of Airbus and establishing a level playing field for trade in large civil aircraft. Ambassador Portman, the recently-confirmed U.S. Trade Representative, already has spoken several times with his European counterpart, EU Trade Commissioner Peter Mandelson, on this subject. He has been crystal-clear in describing the U.S. position. It is up to the Europeans to decide if they are prepared to withhold launch aid while negotiating an agreement, or if they'd rather take their chances in a WTO dispute proceeding.

We look forward to working with you, the members of this subcommittee and other interested members of Congress, and with the U.S. industry, to stop the unfair subsidization of Airbus.

Thank you.

Testimony of Joseph H. Bogosian
Deputy Assistant Secretary for Manufacturing

"U.S. Jet Transport Industry: Global Market Factors Affecting U.S. Producers"
Subcommittee on Aviation
Committee on Transportation and Infrastructure
House of Representatives

May 25, 2005

Role of the Department of Commerce

Good morning Mr. Chairman, Mr. Ranking Member and Distinguished members of the Subcommittee. Thank you for the opportunity to share the views of the U.S. Department of Commerce on the U.S. Jet Transport Industry. I am Joe Bogosian, and I serve as Deputy Assistant Secretary for Manufacturing with the Department's International Trade Administration. In this capacity, I manage the Office of Aerospace and Automotive Industries, as well as offices covering the other manufacturing sectors. These industry offices focus on competitiveness issues for their respective industries, including trade policy activities.

In cooperation with the Commerce Department's Deputy Assistant Secretary of Services and other federal Departments and agencies, my office seeks to ensure open and fair competition in world markets for U.S. civil aerospace products. We regularly assess the competitive state of U.S. manufacturing and service industry sectors, and seek to ensure that government policies and regulations create a level playing field for fair and free competition. Given that the U.S. aerospace and aviation industries are the specific purview of this committee, there are many things that we can do together in support of our shared constituency.

Through our U.S. Export Assistance Centers and our overseas Foreign Commercial Service officers, the Commerce Department helps U.S. companies expand their global reach through trade missions, business counseling and matchmaking services, and participation in air shows worldwide. We also advocate on behalf of the sale of U.S. commercial exports through the Advocacy Center and of military and dual-use goods through the Bureau of Industry and Security. These offices have helped U.S. companies win billions of dollars of awards in overseas procurement competitions by effectively marshaling the full resources of the U.S. Government in their support.

U.S. Jet Transport Study

Mr. Chairman, you will recall that the Department of Commerce recently submitted to this committee a report entitled "The U.S. Jet Transport Industry: Competition, Regulation and Global Market Factors Affecting U.S. Producers." The report responded to a request from your committee to examine market developments and government policies affecting the competitiveness of the United States jet transport industry. Section 819 of the "Vision 100-Century of Aviation Reauthorization Act" (P.L. 108-176) established the objectives of the study. This report also builds on recommendations and conclusions of the November 2002 Final Report

of the Commission on the Future of the U.S. Aerospace Industry. In addition to your committee, we provided the report to the House of Representatives Committee on Science, and to the Senate Committee on Commerce, Science and Transportation.

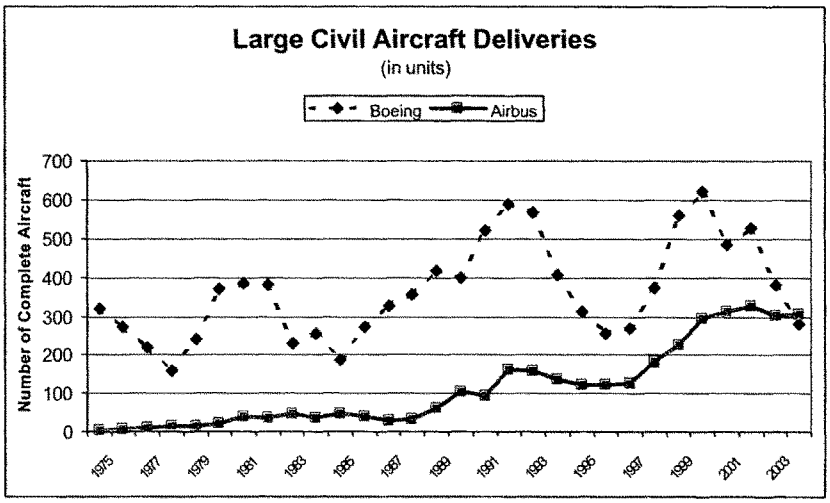
This request provided a unique opportunity to undertake a comprehensive, strategic assessment of the competitiveness of the global commercial airline and jet transport manufacturing industries, to review the many international trade agreements and provisions that directly affect those industries, and to identify some of the potential future obstacles facing U.S. manufacturers competing in an increasingly global market. We present trends and analysis of the impact of U.S. and European government policies on these industries and draw conclusions.

Our report focuses primarily on U.S. and European manufacturers of civil jet transports with 100 seats or more (referred to as large civil aircraft or LCA), as well as of the engines and major subsystems for those aircraft. However, there is some discussion of civil jet transports with less than 100 seats–usually called regional jets (RJs)–given the sizeable participation of U.S. and European aerospace suppliers in these programs and the growing use of RJs in commercial airline fleets. The report also considers the increasing globalization of the aerospace manufacturing industrial base and the blurring distinction between LCA and regional jets in the passenger airline industry.

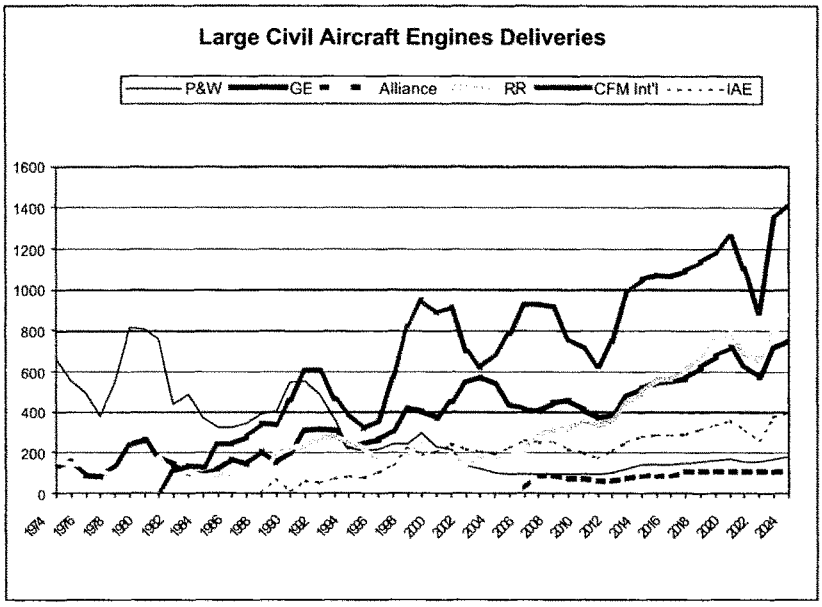
A number of other departments and agencies were instrumental in our development of the report. We consulted with experts in the Departments of Transportation, Justice, Homeland Security, Labor, State, and Treasury; the Federal Aviation Administration; the National Aeronautics and Space Administration; the U.S. Export-Import Bank; and White House agencies including the Office of the U.S. Trade Representative. Input from U.S. and European companies and European governments also was incorporated into the study.

Industry trends

Mr. Chairman, U.S. commercial aerospace companies involved in production of large civil aircraft have lost significant global market share over the last 25 years to their European competitors. The Boeing Company is the only remaining U.S. manufacturer of large civil aircraft (down from three companies in the 1970s—Boeing, McDonnell Douglas, Lockheed), and has laid off nearly a quarter of its work force since September 11, 2001. For the first time in history, in 2003 the European aircraft manufacturer Airbus delivered more new commercial aircraft than Boeing, and it did so again in 2004.



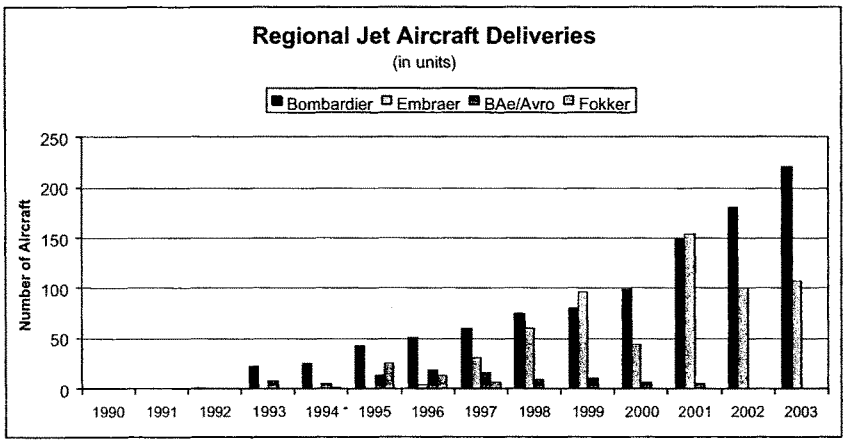
Source: U.S. Department of Commerce analysis of Boeing, Airbus data



Source: *Airline Monitor*, 2004

The two U.S. manufacturers of large civil aircraft engines (General Electric Aircraft Engines, Pratt & Whitney) have experienced similar–albeit less drastic–losses of global market share to their European competitors. They are key partners in the international joint ventures CFM and International Aero Engines (IAE) which represent a growing percentage of the installed fleet of aircraft engines.

We found that the U.S. manufacturers also are facing increased competition from Canadian and Brazilian manufacturers of smaller regional jets, which increasingly are being used by airlines on routes traditionally served by large civil aircraft.



Source: U.S. Department of Commerce, *Speednews*

Some of these changes in market share are the result of evolving global markets and the introduction of new companies, products and services. Aircraft and engine manufacturers are expected to increasingly focus on systems integration and international partnerships to spread the commercial risk associated with new products and to provide best value to their customers. In our view, the largest U.S. firms appear well positioned to maintain a significant presence in global markets. However, U.S. companies that historically supplied parts and components exclusively to U.S. prime manufacturers face more difficulty maintaining their positions in an increasingly global industry. Large and small aerospace manufacturers in other countries such as Russia, Japan, South Korea and China will continue to build expertise and market share, likely at the expense of U.S. producers. U.S. suppliers also will increasingly look to non-U.S. based prime manufacturers for a growing percentage of their business.

The customers of large civil aircraft and regional jets – commercial passenger and cargo airlines – also have undergone a significant transformation over the last twenty-five years. In our report,

we review the structural changes in the airline industry resulting from deregulation in 1978, the evolution of hub-and-spoke networks, the overall stagnation in the airline industry in the early 1990s, and the strong traffic growth from early 1993 through early 2000 led by a second wave of low-cost carriers (LCCs).

Low cost airlines have been able to maintain a substantial cost advantage that allows them to profitably charge much lower prices, although there are some differences among LCC business models. The collapse of demand for high-fare business travelers in late 2000 signaled another structural change in the industry. The ability of legacy carriers to restructure their operations in line with changing market dynamics will be a key determinant of their future role in the industry.

Structural changes in the global airline industry are changing the nature of competition among manufacturers. Increasing service has led to increased procurement of new aircraft, engines, and parts. As markets have evolved, new aircraft models have been introduced to meet new market demands. In particular, increasing liberalization of domestic and international markets has been closely linked to declining average size and increasing operating distance of commercial jet transport aircraft, including rapid growth in the use of regional jets.

Low-cost carriers and financially-strapped legacy airlines will continue to demand less expensive and more efficient aircraft, further spurring innovation. The influence of low-cost carriers is growing as they are placing large orders of new aircraft, usually of a single type, in order to meet aggressive growth targets based on solid financial footing. Aircraft leasing companies and cargo airlines similarly will have an increasing impact on aircraft and engine manufacturer order books.

Recent U.S. airline Chapter 11 filings and the cloud of uncertainty hanging over the passenger airline industry either have not had a drastic impact on manufacturers or have exacerbated their problems, depending on the state of each company before the airline problems began. However, a Chapter 7 liquidation filing by a major U.S. carrier would have a serious impact on regional jet and large civil aircraft and engine manufacturers.

Key policies affecting aerospace manufacturers

Some of the structural changes in the global aerospace industry are due to government policies, funding, and regulations. A strong aerospace industrial base supports national defense and economic security, technology development, scientific discovery, high-wage manufacturing jobs, export revenue, and national prestige. The immense technical challenges and start-up costs associated with the aerospace industry limit the global industrial base to a handful of countries and a few major companies. As a result, national and local governments have a long history of intervening in their aerospace industries to help them grow and prosper in critical global markets.

Since the 1970s, the United States has negotiated and entered into a number of major international agreements that have significantly liberalized trade of civil aircraft products and reduced government intervention in the civil aerospace market. Many of those agreements are specific to the aerospace industry. The overriding objective of those agreements has been to lessen (if not eliminate) the influence of government actions and funding on the aerospace

industry. There has been stated agreement among parties to these agreements that production and purchase decisions should be based on market dynamics, not government interference.

Tariff reductions have been very successful. The level of government intervention across the board has declined with the signing of each successive agreement. However, weaknesses and areas of dispute still remain. Many provisions of these agreements are becoming outdated for an increasingly global industry, and several are under review or renegotiation.

In our report, we review thirteen categories of U.S. and European government policies, and consider the implications of current and future policies on the competitiveness of U.S. manufacturers.

Policies: Financial Support

Government funding for aircraft-related research and development (R&D) has been the single greatest source of trade friction in the civil aerospace industry. The United States and European governments fund research and development related to commercial aerospace technologies in markedly different ways, which are rooted in historical factors and philosophical differences. However, in this report we seek to move beyond the rhetoric that has become so familiar in trade policy debates by clearly comparing and contrasting U.S. and European government funding activities. We hope that the information in this study will truly inform the discussion by dispelling the myth that "everyone gets the same level of financial support, just in different ways." The champions of this argument simply are seeking to preserve the status quo – in which they enjoy the upper hand. The time has come for us to move beyond this tired argument and take a look at the facts.

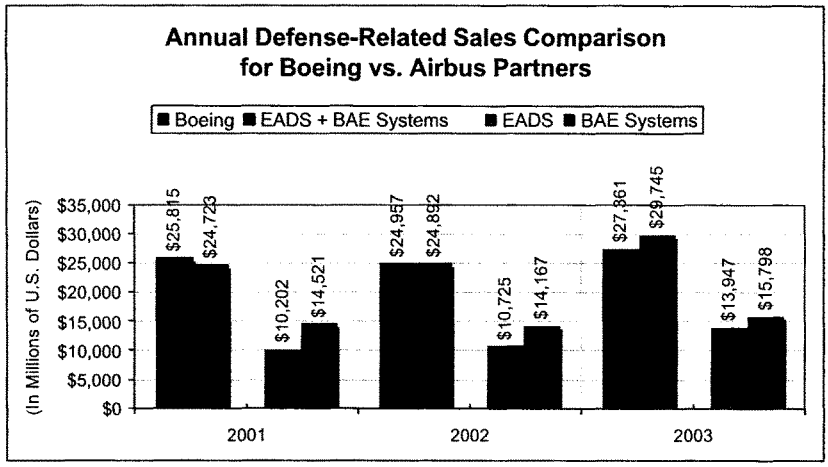
The U.S. government invests public R&D money in development of long-term breakthrough technologies that benefit the public. European governments also invest in basic technology advances, although this funding often is intended to develop new products for near-term application in the large civil aircraft market that will compete against U.S. products. However, unlike the U.S. government, European governments also directly fund development of new civil aerospace products in the form of launch aid (such as royalty-based financing [RBF] or direct loans and grants for aircraft or engine development,) or funding of infrastructure associated with production facilities.

The real distortion of launch aid is in its mitigation of risk; one third of the development costs for new Airbus aircraft and derivatives are provided with no risk to Airbus. Such contingency-based repayment is not available in regular commercial markets. The mitigation of financial risk has a significant impact on decisions to design and produce new models of LCA, given the typical four- to five-year development cycle for a new LCA model and the 10 to 12 years of production required to recoup the manufacturer's capital investment. Airbus has used these subsidies to launch planes in rapid succession, even in low-demand market segments, and to quickly introduce new model derivatives while maintaining a healthy balance sheet.

We describe in the report how the distorting effects of launch aid are exacerbated by diverging levels of funding for civil aeronautical research budgets in the United States and Europe. Also

fundamentally different is the access to the results of U.S. and European government funded civil aeronautical research. The United States and Europe may limit foreign participation in their research programs, but fair competition is particularly compromised by unequal access to the results. European companies can access nearly all U.S. research results. U.S. companies cannot access most EU research results.

In our report, we also seek to bring clarity to the public debate about the relationship between military aeronautics funding and LCA development programs by dispelling two major misconceptions. First, European officials claim that Boeing must have a significant competitive advantage over Airbus, based on a simple comparison of U.S. and European aggregate government defense budgets. However, Boeing and Airbus-family companies actually are similarly positioned in military markets. In fact, Airbus parent companies EADS and BAE Systems, which are Europe's two largest defense contractors, together generate more revenue from defense operations than does Boeing Commercial Airplane Group's parent entity, The Boeing Company.



Source: U.S. Department of Commerce analysis of company financial reports

Second, European claims of U.S. benefits to LCA programs resulting from military programs are vastly overstated. A careful review of their studies shows that they include government expenditures that have no relevance to large civil aircraft programs. In addition, European officials for decades have incorrectly claimed that 25 percent to 50 percent of aggregate DOD-funded research, development, testing and evaluation (RDT&E) carried out by Boeing (and a smaller percentage of RDT&E contracts carried out by other companies) should be considered support to Boeing large civil aircraft programs. Here again, the formulas upon which they are based contain factual and methodological errors.

Perhaps most important, these claims appear to have little relevance for today's industry. The calculations are based on assessments of civil and military aircraft developed in the 1950s (the Boeing 707) and the 1960s (Boeing 747), as well as the anticipated crossover of technology from military fighter aircraft to supersonic and hypersonic civil transport aircraft that were never built. Today more than ever, technologies developed for the military sector are highly specialized and hold little near term value for the civil sector.

International trade disciplines have failed to sufficiently limit government financial support for research and development of aerospace products. We have negotiated bilaterally and multilaterally with our foreign government counterparts, exchanged information and studies, and repeatedly raised concerns at the highest political levels. In 2004, after years of unsuccessful effort to bring more discipline to European government financial support, the United States challenged European government subsidies to LCA manufacturers at the World Trade Organization (WTO). The WTO proceedings were temporarily suspended in January 2005 to provide an opportunity for bilateral negotiations. The United States' objective in these negotiations is to eliminate new subsidies for the development or production of large civil aircraft. There is precedent for the WTO to address aircraft subsidies, although the most recent aerospace subsidy cases, involving Brazil and Canada, have not completely stopped government funding of aircraft development and sales.

Policies: Government Intervention in Sales Campaigns

One of the most difficult forms of government support to address is government political intervention in international aircraft sales campaigns. The U.S. government focuses on neutralizing foreign government intervention in sales campaigns. We urge buyers to base their decisions on the commercial and technical merits of the competing proposals instead of on political factors. Our efforts have met with some success. Nonetheless, our efforts have not been enough. In the report we offer, by way of example, a number of high-profile cases of political intervention by European authorities which raise questions about continued European actions. Unfortunately, international trade disciplines prohibiting these activities have failed to end the practice.

Policies: Export Financing

International agreements have largely eliminated competitive distortions resulting from government-supported export financing. U.S. and European authorities offer such support in line with those agreements through export credit agencies (ECAs). This financing is a critical resource for airlines that otherwise may not have access to affordable commercial financing. The recent ratification by Congress of the Cape Town Convention, which will help to define property rights of creditors and financiers of aircraft transactions, is likely to further enhance global sales of aircraft without providing an advantage to one manufacturer over another.

The U.S. government is working with other Organization for Economic Cooperation and Development (OECD) members to update international rules for officially supported export credits to take into account the changing global market for aircraft. The United States and other OECD members have invited Brazil, not a member of the OECD, to participate as a full

negotiating partner in that review due to their growing presence in the commercial jet transport manufacturing industry. We are actively engaged in these negotiations, having met already three times this year, and with the next round of discussion scheduled for next month.

If successful, these efforts will help to bring government-supported export financing for Brazilian as well as Canadian regional jets into line with ECA support for larger commercial aircraft. These revisions will further help to neutralize financing as a competitive factor in the selection of aircraft. The United States prefers that ECAs serve as lenders of last resort and wants to minimize ECA competition with private-sector financiers, as well as make ECA financing more useful for those airlines that need it.

Policies: Bribery

Government policies related to the practice of bribery by private companies have affected aircraft sales in some countries. The U.S. Foreign Corrupt Practices Act (FCPA) of 1977 prohibits payments by U.S. companies and individuals, including exporters of aircraft, to obtain or retain business and has had a major impact on how U.S. companies conduct international business. Up until 1999, European laws on transnational bribery were nonexistent. Accordingly, some European aerospace manufacturers were widely alleged to have engaged in bribery of foreign public officials to win sales at the expense of their U.S. competitors.

In the report we describe how the U.S. government and the Organization for Economic Cooperation and Development (OECD) Working Group on Bribery are continuing to follow up on obstacles to implementation of the OECD antibribery convention. The U.S. government also is seeking to strengthen OECD and other multilateral and bilateral disciplines related to bribery and corruption of public officials. Recent press reports indicate that European aerospace companies are among the business groups pressing their governments to relax antibribery rules. To the extent that bribery and anti-corruption disciplines and enforcement in Europe remain weaker than under the FCPA, European aerospace companies enjoy a competitive advantage in sales competitions to foreign governments or government-controlled airlines.

Policies: Safety Certification

U.S. and European aviation authorities grant safety and airworthiness certification to commercial aircraft and operators. There is significant international coordination and collaboration among civil aviation authorities on safety certification issues. U.S. and European safety regulations and standards are largely based on global aviation Standards and Recommended Practices (SARPs) developed through the International Civil Aviation Organization (ICAO). Typically, certification decisions have been made according to objective safety-related determinations. On limited occasions, however, certification has been used by European authorities to achieve competitiveness instead of safety objectives. The FAA today is anticipating significant resource challenges. Due to these constraints, manufacturers may begin to turn to Europe to gain initial approvals, thereby placing Europe in a stronger leadership role. Eventually, the United States could face the possibility of lagging behind Europe in promoting standards and procedures in other countries, with possible implications for global competitiveness of U.S. manufacturers.

Establishment of the new European Aviation Safety Agency (EASA) is likely to reduce the cost and time necessary to receive European certification of new commercial aircraft and engine models introduced by U.S. and European companies. Although progress toward establishment of EASA has been slower than initially planned, there is no indication that the new organization will make biased certification decisions in favor of European manufacturers. It will be important for the FAA-EASA relationship to mature sufficiently in time to avoid any delay in certification of new aircraft models such as the Airbus A380 or the Boeing 787. Diverging trends in U.S. and European certification-related technical assistance to other countries could lead over time to a competitive disadvantage for U.S. companies.

Policies: Environmental certification

The environmental impact of aviation is one of the key constraints on future growth of aircraft operations. Governments are giving increased attention to aviation's environmental impact worldwide. Long-standing concerns about local air quality and the impact of aviation noise on communities around airports are amplified by an additional focus on aviation's potential impact on global climate change. Similar to the SARPs for safety certification, ICAO members develop standards and recommended practices for aviation environmental protection as well. Governments then establish domestic standards and regulations related to aircraft noise and emissions, typically based on these ICAO SARPs.

However, there are two key concerns related to aviation environmental standards and policies that may have a significant impact on future relative competitiveness of U.S. and European aerospace companies. First, environmental standards and policies are sometimes abused when they are used to discriminate against U.S. products and services to achieve competition-related as well as environmental objectives. For example, European environmental policies and practices affecting airline operations within Europe could place U.S. manufacturers and airlines at a competitive disadvantage if they are unfairly biased. Our report describes one examples of such a policy which is very familiar to this committee – the European hushkit regulation. European governments finally withdrew this regulation after years of negotiation; in the meantime, the U.S. hushkit manufacturing industry collapsed.

The second area of concern relates to governments competing for their domestic standards to be adopted as international standards. The United States needs to develop an appropriate strategy on civil aviation noise and emissions, and to consider options for future contributions to global standards and procedures in ICAO and elsewhere. Although we have made some progress, we still have a long distance to travel.

Policies: International Air Services

Liberalized international aviation markets benefit all aircraft manufacturers by stimulating demand for air services and therefore overall aircraft sales. Airlines can expand service by tailoring services to specific markets, and taking advantage of a wider variety of aircraft size and range, in turn creating new or expanded markets for a wide range of aircraft models.

Boeing and Airbus appear to be pursuing diverging strategies related to the international air services market. Airbus has been focusing in recent years on the high-capacity, long-range A380 that is geared toward large-capacity flights between major international hub airports. Boeing appears to be focused on building aircraft for increasingly liberalized markets by introducing the long-range but smaller-capacity 787 that is well suited for long routes with comparatively fewer passengers (although Airbus recently announced plans to develop a new aircraft, the A350, with operating characteristics similar to those of the 787). Regardless of industry marketing strategies, the United States has negotiated bilateral and sometimes multilateral "open skies" agreements with every region of the world to expand air services, benefiting U.S. and European manufacturers.

Continued efforts to liberalize the global aviation industry will benefit both U.S. and European manufacturers. We describe in the study how the U.S. government currently is negotiating bilateral and multilateral "open skies" and other more liberalized air services agreements with countries of all sizes and levels of development. Although U.S. and European officials have continued to discuss perspectives on resuming bilateral Open Skies negotiations in 2005, it is unclear what the results would be in the event that the two parties decide to formally restart negotiations, or what the impact would be for aerospace manufacturers.

Policies: Air Traffic Management

Air transportation system policies, standards, and procedures in general are usually intended to affect all operators equally and to have no competitive impact on manufacturers of one nationality or another. Industry and government leaders have invested significant resources and effort to further the goal of global interoperability through global standards and procedures and harmonized requirements.

U.S. and European leaders are beginning to plan the transition to next-generation air traffic management systems, with multiple implications for aircraft and avionics manufacturers, service providers, and even operators of the system. I commend Transportation Secretary Norman Mineta and Federal Aviation Administrator Marion Blakey for their leadership in establishing the groundbreaking Integrated Plan for the Next Generation Air Transportation System (NGATS) here in the United States. The Commerce Department is a key partner in this effort, leading the team that is developing a national aviation weather strategy and participating in teams that focus on other elements of the air transportation system.

U.S. and European authorities must continue to pursue interoperability and avoid divergent standards, technologies, or policies in order to limit the competitive impact of air traffic management advances. Disputes over systems and policies, such as negotiations over future satellite navigation and timing systems (GPS vs. Galileo), are likely to continue as the United States and other countries develop strategies to transition away from the large existing installed air traffic management (ATM) infrastructure base that now exists.

Policies: Airport Infrastructure

There are significant differences among United States and European airports in terms of management, ownership, control and financing. The U.S. Federal Aviation Administration (FAA) provides more centralized planning and financing for airports than its counterpart European Aviation Safety Agency (EASA), but it does not operate any airports, unlike some of the European Union (EU) member state governments. U.S. and European airport development and operations are largely based on ICAO standards and recommended practices. Airport infrastructure upgrades necessary to accommodate new aircraft models (such as the new Airbus A380) typically are funded regardless of the nationality of the aircraft manufacturer.

Airport development policies appear likely to remain largely unchanged in the near future. Although U.S. and European authorities are considering expansions at existing airports and even development of new facilities, such developments will be done in line with existing regulations and policies. However, growing capacity in the global air transportation system will directly impact airports as integral components of that system. For that reason, one of the eight teams developing and carrying out the NGATS Integrated Plan focuses on changes needed in airport-related policies and practices.

Policies: Export Controls

Export controls directly impact international trade in civil aerospace products due to multiple uses for aerospace platforms and components. The technology base that supports the military aerospace industry also supports the civil aerospace industry. While in most cases the hardware is designated as uniquely military or civil in nature, there is a growing population of aerospace systems that are considered either to be civil or military systems based upon relatively minor modifications or differences. This crossover is relevant because different export licensing rules apply to the military and civil versions. As the number of such products increases, export controls will have an increasing impact on trade in commercial aircraft. Export licensing rules also affect international collaboration on development of new commercial aircraft.

U.S. and European authorities are in the process of reviewing export control-related regulations and policies. Resulting revisions could impact collaboration and trade for both U.S. and European companies. Consultation among U.S. and European authorities as they consider requirements for new security-related technologies used on commercial aircraft could help to ensure that export controls do not provide an unfair competitive advantage for one manufacturer or the other.

Policies: Security

Most aviation security policies and requirements affect all aircraft manufacturers the same way, regardless of their nationality. Passengers must go through the same security checkpoints and pay the same security-related fees as part of their airplane tickets, regardless of whether they are flying on a Boeing or an Airbus aircraft or a regional jet. The U.S. government has sought to maintain a balance between ensuring the security of the U.S. aviation system and facilitating the movement of people and goods.

Current aviation security policies and requirements clearly have an impact, albeit often indirect, on U.S. aircraft manufacturers. U.S. airlines have expressed significant concern over a wide variety of security-related costs that affect their ability to purchase, operate and maintain aircraft. Consumer demand also is affected by the "hassle factor" associated with new security screening procedures. A few aviation security requirements, such as mandatory security-related equipment (e.g. reinforced cockpit doors), directly impact aircraft manufacturers but thus far have not provided one manufacturer a notable competitive advantage over another. This could become a growing issue as new security measures are contemplated to counter threats such as man-portable air defense systems (MANPADS).

Policies: Mergers and Acquisitions

Merger reviews under U.S. antitrust law focus on preserving market competition, to the ultimate benefit of consumer welfare. European antitrust reviews have in the past tended to focus on prevention of market domination by a leading firm. Increasing integration of U.S. and European markets has led to EU competition authorities reviewing and requiring conditions upon mergers among U.S. manufacturing companies that have no significant production facilities in Europe. U.S. and European authorities have agreements related to their independent reviews of specific mergers and acquisitions. There is no evidence of a broad EU policy intended to provide European companies a competitive advantage, although some of the highest-profile disputes have centered on aerospace company mergers.

U.S. and European governments are not currently pursuing major revisions to merger and acquisition policies. Trans-Atlantic collaboration on policy and merger reviews through formal working groups will help to narrow any remaining differences in government policies. Nonetheless, it will be important to carefully monitor aerospace merger reviews in the future as consolidation of the aerospace industry continues, especially any potential competitive effects of establishing new "national champions."

Policies: Taxation

Numerous federal, state, and local taxes ranging from the alternative minimum tax to depreciation schedules and international provisions of the Internal Revenue Code affect the manufacturing industry. Domestic tax policies related to the international sale of aerospace products have the most direct impact of all taxes on the U.S. aerospace manufacturing industry, especially given that a significant majority of aircraft, engines, and parts are sold to international customers. Aviation-specific taxes affecting the operators have an indirect impact on manufacturers inasmuch as they affect overall market demand.

Aviation-specific taxes and fees do not have much effect on the competitive standing of U.S. vs. European manufacturers in global markets. While reduced taxes and fees would reduce costs to aviation service providers and passengers, thereby providing at least some indirect benefit to aerospace manufacturers, there is likely to be an accompanying reduction in aviation infrastructure investment with downline implications. Non-aviation-specific taxes directly affect aircraft manufacturers as well as operators. In particular, many U.S. aerospace companies

benefited from since-repealed Foreign Sales Corporation and similar tax policies, based upon their volume of international sales. The exact impact of new tax provisions adopted in 2004 on U.S. companies is unclear. However, since the European tax regime remains unchanged, European manufacturers may now enjoy a competitive price advantage in global competitions relative to their U.S. competitors.

Next steps

As I mentioned earlier, we believe that many provisions of the existing aerospace-related agreements and policies are becoming outdated for an increasingly global industry. We are reviewing each of these agreements and policies, in close consultation with U.S. industry and other federal agencies, to determine how to strengthen or revise them to reflect current market realities. For example, we are seeking recourse through the WTO and through bilateral negotiations to bring an end to subsidies for development of new large civil aircraft. We are working with our foreign counterparts to update international aircraft finance and bribery provisions.

We are working with other countries to develop new global standards and recommended practices, and with other agencies here at home to transform the air transportation system. Our negotiations aimed at increasing liberalization of international air services will further support expansion of the global aviation system. We remain vigilant in our efforts to identify and neutralize government policies that create an uneven playing field, and in our efforts to address the challenges facing the aging aerospace workforce.

We appreciate the opportunity to discuss our report and findings with this committee. Hopefully this report will contribute to the discussion of the many difficult issues facing this critical segment of our manufacturing industrial base. Through our common efforts in support of our shared constituency, together we can effect the changes that must take place to ensure strong, competitive aerospace and aviation industries. I welcome your comments on the issues we review in our study, and look forward to answering any questions you have. We also are working to organize a public hearing in the near future to solicit feedback on the study, in coordination with other relevant federal agencies.

The study is available on the International Trade Administration's Internet site (www.ita.doc.gov/td/aerospace/jet_transport_study.htm). It also is available for purchase as a paper, microfiche, or electronic reprint from the National Technical Information Service, 5285 Port Royal Road, Springfield, VA 22161; www.ntis.gov. If the committee decides it would be helpful to do so, the study could be included as part of the record of this hearing.

As a final note, I would like to commend the staff in the Office of Aerospace and Automotive Industries and their counterparts from other agencies and departments for their diligence and skill in developing and producing this comprehensive study. Their hard work over many months has yielded a unique tool. Now it is in our hands to put that tool to good use.

Testimony of Marc L. Busch[1]
To the House Aviation Subcommittee
May 25, 2005

Chairman Mica, Ranking Member Costello, thank you for the invitation to appear before the subcommittee today to discuss global market factors affecting the US jet transport industry. I applaud the subcommittee for its leadership in examining this important topic.

As the commercial rivalry between Boeing and Airbus intensified through the late 1980s, then USTR Ambassador Michael Smith warned a House subcommittee that "decisions about launch aid and things like that should not be taken lightly, either by the governments involved or by the industries involved."[2] With the United States and Europe once again on the brink of litigating civil aircraft under international trade rules, Ambassador Smith's testimony is just as relevant today. Indeed, launch aid "and things like that" continue to be a source of considerable tension in the industry, especially in anticipation of the head-to-head competition between Boeing's 787 and Airbus' A350. As was true in the late 1980s, the current dispute centers on U.S. charges that Europe provides *direct* launch aid and other financial support to Airbus, whereas Europe counters that the U.S. gives *indirect* subsidies—notably in the form of NASA and Department of Defense R&D grants—and other assistance to Boeing.[3] Is this, as Yogi Berra might have put it, "like déjà vu all over again"?

Some things about this commercial rivalry have certainly not changed. Most saliently, the civil aircraft industry remains a catalyst of economic growth and competitiveness, both because it provides a lot of high-paying jobs, and because it exhibits leading-edge technological spillovers that benefit other sectors. Combined with the industry's export prowess, these factors ensure that governments will always take a keen interest in civil aircraft manufacturing.[4]

Other things about this commercial rivalry have undoubtedly changed. There are, in particular, two notable differences between the landscape of the current dispute and the one that gave rise to the 1992 Large Civil Aircraft (LCA) Agreement: competition from regional jet makers who are, at times, subsidized; and the negotiation of stricter disciplines on subsidies, coupled with a better dispute settlement mechanism, under the World Trade Organization (WTO). First, the regional jet market, which is dominated by

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[2] *Competitiveness of US Commercial Aircraft Industry*. Hearing before the Subcommittee on Commerce, Consumer Protection and Competitiveness of the Committee on Energy and Commerce, 100th Congress, 1st Session, June 23, 1987, p. 24.

[3] See the U.S. request for WTO consultations, *EC and Certain Member States—Measures Affecting Trade in Large Civil Aircraft* (WTO Document WT/DS316/1), and the European request for WTO consultations, *US—Measures Affecting Trade in Large Civil Aircraft* (WTO Document WT/DS317/1).

[4] Marc L. Busch, *Trade Warriors: States, Firms, and Strategic-Trade Policy in High-Technology Competition* (NY and Cambridge: Cambridge University Press, 1999).

Canada's Bombardier and Brazil's Embraer, is increasingly vying for orders against Boeing and Airbus offerings. Specifically, the Department of Commerce explains that Embraer is "starting to blur the traditional line between large civil aircraft and regional jets" with its 100+ seat offerings, a move Bombardier is "seeking to match" with new aircraft in the 130 seat range.[5] By crossing the 100 seat threshold that has long defined this market segment, Bombardier and Embraer will compete directly with smaller airplanes from Boeing and Airbus. Thus, while much attention has been paid to the flight test of Airbus' huge A380, which will go head-to-head with Boeing's 747, both companies will increasingly have to contend with Bombardier and Embraer, competition that Boeing's *Current Market Outlook* predicts will be formidable.[6] More worrisome still, this competition has been subsidized in the past, and there is renewed concern that Canada and Brazil will be backing their national champions as they bring their new products to market. In short, subsidized competition in civil aircraft is a more widespread problem than it was the last time the U.S. and Europe were on the brink of international trade litigation.

Second, and related, the WTO is a more viable forum in which to litigate trade tensions over civil aircraft than was its predecessor, the General Agreement on Tariffs and Trade (GATT). This is because the WTO negotiated stronger disciplines on subsidies, and provides an improved dispute settlement mechanism to adjudicate these disciplines. In the early 1990s, when the U.S. and Europe readied to argue their cases before the GATT, the relevant disciplines on subsidies, and the dispute settlement mechanism, were not widely seen as being up to the task. The dispute settlement mechanism, in particular, was viewed with suspicion, given the possibility that a GATT ruling could be "blocked" by the losing side. Since it is not possible to block rulings at the WTO—or to block requests for authorization to retaliate, for that matter—there is a sense that litigation may be more efficacious this time around.

Taken together, these two differences suggest that WTO litigation may be the right call. For the most part, dispute settlement works by encouraging negotiation in the "shadow of the law." As my research with Eric Reinhardt of Emory University shows, the fullest concessions (i.e., granting improved market access or trade liberalization) are typically negotiated *before* a panel issues a ruling, either in consultations (which precede a panel request) or at the panel stage in advance of a verdict.[7] We call this "early settlement," and find that, just like under GATT, it tends to produce the most favorable outcomes under the WTO, especially in disputes involving the U.S. and Europe.[8]

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[5] U.S. Department of Commerce, *The U.S. Jet Transport Industry: Competition, Regulation, and Global market Factors Affecting U.S. Producers* (Washington, DC: International Trade Administration, 2005), pp. 40, 43.

[6] Boeing, *Commercial Market Outlook* 2004, p. 12.

[7] Marc L. Busch and Eric Reinhardt, "Developing Countries and GATT/WTO Dispute Settlement," *Journal of World Trade* 37 (4) 2003: 719-735; and Busch and Reinhardt, "Bargaining in the Shadow of the Law: Early Settlement in GATT/WTO Disputes," *Fordham International Law Journal* 24 (1) 2001: 158-172.

[8] Marc L. Busch and Eric Reinhardt, "Transatlantic Trade Conflicts and GATT/WTO Dispute Settlement," In Ernst-Ulrich Petersmann and Mark A. Pollack (eds), *Transatlantic Economic Disputes: The EU, the US, and the WTO* (Oxford: Oxford University Press, 2003).

Of course, in the current civil aircraft dispute, the U.S. and Europe did *not* settle early in consultations, nor during the recent "cease fire" in the lead up to a panel request. And while it is still possible that an agreement might be reached before a WTO panel rules, this dispute is likely to go the legal distance. What can we expect?

The experience of Canada and Brazil at the WTO is instructive. Both sides challenged each other's subsidy schemes, chalked up a few legal victories, and won authorization to retaliate. And while neither has followed through on retaliation, the legal victories have done two things. First, the WTO rulings have curtailed the use of certain subsidy programs. For example, Canada won legal victories against two versions of Brazil's export-financing scheme (PROEX I and PROEX II), and largely handcuffed a third (PROEX III), thereby reshaping the playing field in regional jets. For its part, Brazil prevailed in a case over support Bombardier received on a sale to Air Wisconsin, but failed to convince the WTO that other Canadian subsidy schemes were illegal. These decisions were thus important for the companies involved, and brought greater legal clarity to the issues contested by the two governments. Second, these WTO rulings have pressured both sides to return to the bargaining table to seek a long-term solution to their dispute. Indeed, Canada and Brazil have formed a technical working group to negotiate a lasting peace, one informed by the rulings issued by the Geneva-based trade institution.

In the current U.S.-EC dispute, WTO litigation can be expected to accomplish three things. First, the litigation will help clarify which subsidy programs are illegal under international trade rules, and which are not. Second, the litigation will impact not only the U.S. and Europe, but Canada and Brazil as well, in the sense that WTO rulings influence how subsequent cases are decided. For this reason, Canada and Brazil are likely to reserve "third party" rights in cases brought by on behalf of Boeing and Airbus, looking to influence these legal decisions. Third, the results of this litigation will likely encourage the U.S. and Europe to return to the negotiating table, although to be successful, these talks should also include Canada and Brazil. The 1992 LCA Agreement was forward-looking in this regard, recognizing the need to "multilateralize" disciplines on civil aircraft subsidies despite the bilateral nature of the accord. While this was visionary at the time, the need for multilateral talks today is simply a reflection of the new landscape of the civil aircraft industry.

OPENING STATEMENT OF
THE HONORABLE JERRY F. COSTELLO
AVIATION SUBCOMMITTEE
THE U.S. JET TRANSPORT INDUSTRY:
GLOBAL MARKET FACTORS AFFECTING U.S. PRODUCERS
MAY 25, 2005

- I want to thank you, Chairman Mica, for calling today's hearing to examine the competitiveness of the U.S. aircraft manufacturing industry. I am dedicated to ensuring that U.S. companies can compete on a level playing field. America's aerospace workers deserve no less.

- The U.S. has long been a world leader in virtually every aspect of aviation. Our leadership in this field provides a major benefit to our citizens, as aviation is a critical element in the nation's economy and contributes greatly to our balance of trade. In 2004, aerospace made up approximately 7% of all U.S. exports and provided a trade surplus of $31 billion.

- However, there are many questions circulating regarding the fairness and equity of competition, regulation, and global market factors affecting the aircraft transport industry.

- Boeing, the nation's largest exporter of manufactured goods, has paid a heavy price for many anti-competitive behaviors, as outlined in the Department of Commerce's report on *The U.S. Jet Transport Industry: Competition, Regulation, and Global Market Factors Affecting U.S. Producers*, including:

    - A loss of 20 percentage points of market share in just the last five years;

    - Significant sales losses due to other's ability to use its subsidized advantage to dramatically undercut pricing on airplanes; and

    - The loss of tens of thousands of high-paying American manufacturing jobs, including many in and near my district.

- The U.S. must take a strong stance against any trade barriers or protectionist measures that hamper U.S. manufacturers from competing on a level playing field. To that end, I look forward to hearing from Ambassador Allgeier on the U.S.'s trade case against the European Union before the World Trade Organization regarding the subsidies provided to Airbus.

- We must also take a hard look at the lack of adequate funding for basic aerospace research and development, which is a significant impediment to the future of the U.S. large civil aircraft manufacturing industry. NASA's research budget has steadily declined over the last decade from a high of $1.54 billion in FY94 to the FY06 budget request of $852 million. To understand the effects of this lack of basic R&D funding on the aerospace industry, I have requested that the Government Accountability Office conduct a comprehensive assessment of U.S. aeronautical research and development efforts and a comparison of these efforts with those of the European Union and other nations.

- I look forward to hearing from the witnesses' testimony on competition in the aircraft manufacturing industry.

STATEMENT BY
MR. JOHN W. DOUGLASS
PRESIDENT AND CHIEF EXECUTIVE OFFICER
AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA

Hearing on "The U.S. Jet Transport Industry: Global Market Factors Affecting U.S. Producers"

House Committee on Transportation and Infrastructure
Subcommittee on Aviation

May 25, 2005

Introduction

Chairman Mica, on behalf of the Aerospace Industries Association of America, or AIA, I wish to thank you, Representative Costello, and the members of the Aviation Subcommittee for the opportunity to testify on the complex manufacturing market environment of today's air transportation industry. AIA represents more than 100 regular and 180 associate member companies, and we operate as the largest aerospace manufacturing trade association in the United States. With more than 606,000 engineering and production workers, we also have a long history in the management of air transportation issues.

The March 2005 Department of Commerce report entitled, "The U.S. Jet Transport Industry: Competition, Regulation and Global Market Factors Affecting U.S. Producers" provides an excellent basis for today's hearing. Whether it is global competition in the airframe and engine markets, the race to implement the Next Generation Air Transport System, dwindling domestic investments in aeronautics research or Europe's government supported aircraft development, the report provides a concise overview of many of the challenges facing our industry today.

With that report as a backdrop, I will begin my statement with a discussion of the rich aerospace trade relationship between the United States and Europe to emphasize the importance of resolving disagreements over the elimination of aircraft subsidies and averting a trade war. I will then turn to an overview of U.S. and world aviation market trends, including an analysis of the growth of the European industry, based on data generated by AIA and its membership. Finally, I will propose a number of policy and budgeting initiatives that could support both a rebound in the nation's aviation market share and a more competitive industry worldwide.

The International Aerospace Trade: An Engine of Employment and Innovation

AIA, Mr. Chairman, strongly urges the United States and the European Union (EU) to negotiate the elimination of subsidies so that commercial aircraft competition will be on a level playing field.

The stakes in the U.S.-EU negotiations remain high. AIA member companies export 15-20 percent of their military and nearly 70 percent of their commercial products and aerospace continues to lead the entire manufacturing economy in providing a positive balance of trade. Last year, as the nation's overall trade deficit soared to a record level of more than $650 billion, the domestic aerospace industry posted a $31 billion trade surplus.

European customers consume more than 40 percent of U.S. aerospace exports, and sales to the EU in 2004 alone exceeded $22 billion value. Trade with Europe also contributes to our impressive rate of job creation. Aerospace companies accounted for nearly one-in-six of all the manufacturing jobs created in the U.S. last year with employees earning nearly 45 percent more than the average production wage.

High-paying jobs at home and state-of-the-art technologies for the American war fighter abroad depend on open markets in Europe unfettered by political or trade disputes. The EU has an equally strong interest in a free and open aviation sector since Airbus sells more than 40 percent of its commercial airliners to U.S. buyers. For these compelling reasons an equitable trans-Atlantic trade relationship based on clear export and investment standards is critical.

Civil aviation competition from the EU is clearly significant. In January 2001 the EU authored a plan entitled *European Aeronautics: A Vision for 2020*. This document adopts the multilateral objective of "a world-class European aeronautics industry that leads in global markets for aircraft and engines." EU officials take an integrated, strategic view of aerospace and aeronautics. *Vision 2020* notes that trade, investment, tourism, and political ties to emerging markets all depend on a vibrant air transportation industry.

United States and Global Aviation Market Trends

A look back at the history of commercial aviation illustrates the urgent need for the United States and the European Union to shape a market-driven framework for the air transportation industry.

From the inception of powered flight in December of 1903, through the move to jet aircraft, U.S. corporations such as Boeing, McDonnell-Douglas, Lockheed, Vought, Pratt and Whitney and General Electric have claimed world leadership in the construction of civil airframes and propulsion systems.

This century-long dominance has recently been eroded due to strong competition from around the world. Whether coming from Europe, Canada, or Brazil, the challenge to U.S. leadership in global commercial airframe and engine markets could not be clearer.

As recently as 1985, the airframe market was dominated by three domestic companies with Boeing, McDonnell-Douglas and Lockheed, producing seven airframe models and delivering more than 270 aircraft that year alone. Lockheed's exit from the large civil aircraft market in 1985, followed by the egress of McDonnell-Douglas in 1997, left Boeing as the sole domestic airframe manufacturer. By 1996, Airbus had

experienced unprecedented growth more than doubling aircraft deliveries by 1999, and breaking the 300 level (311) by 2000. In 2003, Airbus delivered more aircraft than Boeing for the first time in history. The domestic engine market has seen a similar decline in market share.

This dwindling U.S. market is only part of the picture. To fully understand the current situation in the jet transport industry, it is important to consider the growth of international competition.

The 1992 Bilateral Agreement on Large Civil Aircraft placed limits on government support of commercial aircraft development by Airbus. At the time of the agreement, the world jet transport market was dominated by U.S. suppliers. The chart below examines the size of Boeing and Airbus in 1993 and in 2004:

	Aircraft Deliveries	Product Lines	Revenue	Employees
1993 Airbus	138	4	$8.8 billion	38,000
1993 Boeing	*330*	*4*	*$20.6 billion*	*75,000*
2004 Airbus	320	12	$25.1 billion	51,959
2004 Boeing	*283*	*7*	*$21 billion*	*52,669*

Airbus has moved from an airframe manufacturer producing 138 planes in 1993, to one which eclipsed its sole competitor, Boeing, in aircraft deliveries by 2003. Prior to its termination in 2004, the 1992 agreement had already long outlived its purpose.

AIA commends the U.S. government on its decision to withdraw from the 1992 Bilateral Agreement. Boeing and Airbus are now corporations of equal standing, and policies on both sides of the Atlantic must reflect this reality. Thus, one point is clear: government support via launch aid is no longer necessary or appropriate.

Factors Driving the Shift in Market Share

Although today's air transportation business models eliminate any need for launch aid, foreign governments have a long record of assisting their aerospace industries to facilitate growth and prosperity in critical global markets. Specifically, Airbus receives launch aid consisting of low interest loans for aeronautics product development that is only payable if a product begins to sell in significant volume and becomes a commercial success.[1] Launch aid therefore shields companies, like Airbus, from assuming complete

[1] Under Airbus' agreements with European governments, the first loan repayment threshold occurs when the airplane reaches 40 percent of projected total sales. Only then does Airbus have to start repaying the loan and all that is due at this point is 20 percent of the total launch aid for a given airplane.

According to the 1992 European Commission – United States agreement on trade in large civil aircraft (LCA) direct government support can not exceed 33% of the total development costs for new aircraft programs. The support must be repayable royalty-based loans which will be repaid at an interest rate no less than the government cost of borrowing and within no more than 17 years. Indirect support is limited to a 3% of the nation's LCA industry turnover.

commercial risk, and allows producers to pursue more aggressive pricing and financing practices because the debt is not automatically assumed.

Since its inception in 1970[2], Airbus has benefited from a total of $15 billion in launch aid, including $3.2 billion[3] for the new A380. Media reports indicate that Airbus has accumulated approximately $2 billion in cost overruns on the A380, but will likely ask European governments to offset a portion of these costs. U.S. industry estimates that over the years, launch aid has allowed Airbus to keep at least $35 billion in debt off of its books. European treasuries have shielded Airbus from the same market risks that face Boeing and other commercial competitors. In the European aviation sector, employment and political prestige considerations trump market requirements.

The proprietary nature of European research produces another competitive advantage to the continent's aviation industry. EU governments, unlike NASA, restrict international access to their aviation R&D and concentrate heavily on product-specific, near-term research in attempts to expand civil market share.

At the end of March, the *Advisory Council for Aeronautics Research in Europe*, a branch of the European Commission (EC), released a new blueprint requesting a 70 percent increase in R&D spending over the next twenty years, for a total of $221 billion[4], on five "high-level target concept" areas: operational cost reduction, safety, delays, airport and airframe security, and environmental improvements among others. The Centers of Excellence, as part of the European Research Area, are also tasked with reducing development costs and time to market for European aviation products. The EU clearly understands the benefits of a robust aviation industry.

Towards a Recovery of U.S. Aviation Leadership

The ability of U.S. industry to transform emerging technologies into innovative products is unmatched in the world. This capability depends on a solid foundation in basic engineering and scientific research where new and novel high-risk concepts can be explored and proven in a low-risk, non-commercial environment independent of business considerations. Entrepreneurs and established companies can then advance these emerging technologies, developing products and capabilities in ways that were often not imagined when the fundamental research was preformed.

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[2] Airbus was established in 1970 as a European consortium of French, German and later, Spanish and U.K companies. In 2001, thirty years after its creation, Airbus formally became a single integrated company. The European Aeronautic Defense and Space Company (EADS), (resulting from the merger between Aerospatiale Matra SA of France, Daimler Chrysler Aerospace AG of Germany and Construcciones Aeronauticas SA of Spain), and BAE SYSTEMS of the UK, transferred all of their Airbus-related assets to the newly incorporated company and, in exchange, became shareholders in Airbus with 80 per cent and 20 per cent respectively of the new stock. http://www.airbus.com/about/history.asp

[3] Business Week Online, "Boeing vs. Airbus: Time to Escalate," March 21, 2005.

[4] Aviation Week & Space Technology. "New Agenda." April 4, 2005. (p. 39).

Since the early days of aviation, the U.S. government has played a critical role in advancing basic aeronautics research, first under the National Advisory Council on Aeronautics (NACA), and then at NASA. Our nation, and indeed the whole world, has benefited from these investments since they have been openly shared in the scientific and aeronautics communities. This research has provided the fundamental building blocks leading to U.S. leadership in commercial aviation.

NASA's recent lack of attention to basic and applied aeronautics technologies will impair U.S. industry's future ability to compete in the global marketplace. The situation is dire. NASA's aeronautics funding has shrunk from a high point of $1.54 billion in FY94 to a proposed $852 million in the President's FY06 budget request, with a projected decline to $717 million in FY10. The U.S. must renew its commitment to aeronautics research by establishing a strong national policy that emphasizes the importance of aeronautics to our economic and national security. This national policy will meet with success only if a comprehensive aeronautics plan is accompanied by adequate annual funding. The recently released report "Responding to the Call: An Aviation Plan for American Leadership," by the National Institute for Aerospace (NIA), provides a clear illustration of the type of comprehensive aeronautics research program that is necessary.

The previously mentioned European plan, *Vision for 2020,* sets the sights for Europe to not only lead the world in aviation products, but also for leadership in the development of regulations that govern aviation. The European Aviation Safety Agency (EASA) became operational in 2003, assuming many of the responsibilities of the EU member states' national aviation authorities, and has already become major player on the international stage.

While Europe now has a central aviation authority, it still retains each of its 25 national votes at the United Nations' International Civil Aviation Organization (ICAO), where the international standards for aviation are established. Nevertheless, the EU continues to lobby for independent recognition by ICAO. This block of votes leads to the real possibility that Europe could dominate ICAO proceedings to their competitive advantage. An example of this possibility came in the late 1990's when the European Union banned use of all aircraft powered by Pratt & Whitney JT8D engines based on their design, even though the engine's noise reducing hush kits performed acceptably within the ICAO standard. Only after vigorous activity by the U.S. and the leadership of ICAO, was industry successful in stopping this European attempt to gain competitive advantage through the use of ICAO standards.

To counter these possibilities, the U.S. must ensure it remains highly attentive to matters under consideration at ICAO. The position of U.S. Representative to ICAO remains vacant. AIA and industry believe it is imperative that the Administration and Congress take action to fill this critical position as quickly as possible.

Conclusion

It is in neither the best interest of the United States nor the European Union to have a trade war that would damage the global aerospace industry and undermine economies throughout the world. Boeing and Airbus have established themselves as the world's preeminent large commercial aircraft manufacturers, and in doing so, have contributed to transportation-driven economic growth in both Europe and North America. Officials on both sides of the Atlantic must build a consensus to negotiate a comprehensive agreement that will end launch aid and in so doing make the civil aircraft market more competitive. Such an agreement would avert a potentially long and acrimonious dispute in the World Trade Organization.

Events of recent days have not provided much cause for optimism as a result of a launch aid request by Airbus to European governments to subsidize its proposed A350 aircraft. An affirmative response to this request would end the mutually-agreed cessation of government support for new aircraft development that expired in April. This aid, expected to total more than $1.6 billion, would allow Airbus to begin development of its new aircraft designed to directly challenge the new Boeing 787. According to the Financial Times, "Airbus executives as well as European officials have been concerned that a prolonged subsidy freeze would delay the chances of the A350 challenging Boeing's most ambitious and promising project, the 250-seat 'Dreamliner' 787."

Herein, Mr. Chairman lies the problem. Launch aid provided by European governments allows Airbus to develop new aircraft with little concern for the traditional market forces that normally govern the industry. Due to this aid, Airbus is able to assume more risk and possible debt than a company relying solely on private financing.

The 1992 Bilateral Agreement is no longer in force. A newly negotiated agreement must level the competitive playing field between large aircraft manufacturers and include a prohibition against direct government launch aid subsidies in accordance with the codes of the WTO.

In 2004, Boeing delivered 285 aircraft; Airbus delivered 320. In the same year, Boeing announced 272 orders and had a backlog of 1,092 as compared to Airbus' 370 orders and backlog of 1,500 airplanes.

The playing field, Mr. Chairman, is now level in every possible measure with the exception of government support. As Boeing continues to develop aircraft like the 787 and assumes ever higher levels of business risk, Airbus should not be allowed to flourish under the protective cloak and open treasuries of European governments.

OPENING STATEMENT

Bryan T. Moss, President

Gulfstream Aerospace

Before

U.S. House of Representatives

Subcommittee on Aviation,
Committee on Transportation and Infrastructure

May 25, 2005

STATEMENT OF BRYAN MOSS

Mr. Chairman, members of this distinguished Subcommittee on Aviation, on behalf of Gulfstream Aerospace Corporation's more than 7,000 dedicated employees; it is a distinct honor for me to appear before you today.

As most of you know, our company is a leading United States based manufacturer of mid and large-size cabin business jet aircraft. We are a General Dynamics company and have been exclusively in the business of manufacturing and servicing business jet aircraft for more than 47 years.

At the outset of this testimony I wish to extend on behalf of my company and the general aviation industry deep appreciation for all that this subcommittee has done, and continues to do, to help the industry remain competitive under diverse, and often challenging, market conditions. We are halfway through the 4 year FAA Reauthorization Bill. This Bill, which falls directly under the subcommittee's purview, has provided the basic foundation and operational guidelines responsible for the health and vitality of the industry today. We thank you for your

leadership. Additionally, I would be totally remiss if I didn't thank you for your early recognition and support for the important role that bonus depreciation ultimately played in assisting our industry cope with the declining market condition following the 9/11 tragedy. Congressional passage of the President's Jobs Creation Act of 2003, in late May of that year, with bonus depreciation as an integral part of the law, provided a huge stimulus to increased sales which put the industry on the comeback trail. The Congress' timely action in extending the

bonus depreciation provisions for an additional year ensured the recovery had endurance.

FAA CERTIFICATION

As we move forward to today, and looking at matters from a competitive prospective, I must tell you that a couple of industry issues before the subcommittee give us cause for concern. We respectfully ask that you take a serious look at the FAA in the area of certification services. The FAA has proposed reduced manning levels for certification services which, if implemented, would provide a severe economic hindrance to our company's ability to bring new products into

service. Additionally, these delays would directly inhibit our ability to remain competitive in the challenging marketplace previously referenced. At this time of proposed reductions in U.S. certification services, the European Union has enhanced its thrust in this area with the establishment of the European Aviation Safety Agency (EASA) and a robust operating budget. I've spoken with many of you on this issue and would welcome any dialogue you might wish to have today, or in subsequent meetings.

USER FEES

Another concern I have regarding our industry's well being is the issue of user fees for aviation services. While the FAA Reauthorization Bill and the Airport and Airway Trust Fund (AATF) excise taxes do not expire until September 30, 2007, discussion is already underway on how the next reauthorization should proceed. These discussions center on the issues surrounding aviation excise taxes, the FAA's budget, and the declining general fund contribution to the FAA. Let me say clearly that we are supportive of the current aviation excise tax on aviation fuel as the

means for our industry to contribute to the AATF. We are not, however, supportive of increased user fees and excise taxes to make up for the shortfall created by a declining general fund contribution. The aviation industry cannot bear the total burden of the funding disparity and remain healthy. Please take a serious look at this issue as discussion and debate proceed towards a resolution.

NASA Aeronautics Research Funding

Another area that I bring to your attention extends beyond the immediate scope of this subcommittee, but it is one that has wide spread

implications to the aviation industry as a whole. It involves NASA's Aeronautics Research and Development activities. I believe it is extremely important that our Nation understand and recognize the significant contributions that aeronautics research has made to the United States' leadership in aviation. This leadership is being lost. The Aeronautics research budget has been decreased by more than 50% since 1994 while recently the "Advisory Council for Aeronautics Research in Europe" has called for a 70% increase in spending over the next twenty years. It is my firm contention that this

leadership loss will have far reaching impact on national security, the well-being of our economy, aviation safety, and our industrial competitiveness. I appreciate the opportunity to bring these serious concerns to your attention.

SUBSIDIES AND OTHER CONSIDERATIONS

Lastly, I would like to take a moment to address our concern regarding government subsidies to foreign aircraft manufacturers. As a domestic U.S. aircraft manufacturer, we see increasing pressure from foreign aircraft entering the business jet market. These new entrants fall into categories of business jet unique and

regional jet (RJs) conversions. The same financial calculus that applies to large commercial aircraft applies to business jets. Simply stated, government subsidy manifested in development loans, with low or no pay back, and production start up loans with similar terms, results in severe competitive disadvantage. Specifically, market risk is significantly diminished for the government subsidized manufacturer. New aircraft are being introduced with little to no debt assumption and aggressive pricing is prevalent without regard to return on investment. Private and publicly held

companies, relying on profits and borrowing abilities, cannot compete with National treasuries.

CONCLUSION

Mr. Chairman, the time is upon us to consider extending the application of a new Bilateral Agreement on large civil aircraft to include all aircraft.

OPENING STATEMENT OF
THE HONORABLE JAMES L. OBERSTAR
AVIATION SUBCOMMITTEE
THE U.S. JET TRANSPORT INDUSTRY:
GLOBAL MARKET FACTORS AFFECTING U.S. PRODUCERS
MAY 25, 2005

I want to thank you, Chairman Mica and Ranking Member Costello for calling today's hearing to examine the competitiveness of the U.S. aircraft manufacturing industry. Some in the private and public sectors have posited theories that the U.S. aircraft manufacturing industry has lost its competitive edge. I believe that competition is good for any industry – including aviation. I am confident that the U.S. aerospace manufacturing industry will rise to the challenges posed, and remain a strong competitor in the future.

As we discuss the various aspects of aerospace competition – from research and development, to certification and validation processes, to new aircraft financing – we must not take an isolationist or protectionist stance. Instead, we must focus on enabling U.S. aircraft manufacturers to build better aerospace products that will sell themselves in the global marketplace despite trade obstacles that may exist on <u>both</u> sides.

The U.S. has long been a world leader in virtually every aspect of aviation. Our leadership in this field provides a major benefit to our citizens as aviation is a critical

element in the nation's economy and contributes greatly to our balance of trade. In 2004, aerospace made up approximately 7% of all U.S. exports and provided a trade surplus of $31 billion.

However, both U.S. and European aerospace manufacturers are facing new competition as national aerospace industries emerge around the world. China and Russia are developing or expanding their own aerospace manufacturing industries, and U.S. and European manufacturers will certainly face increased competition from Canada and Brazil, as Bombardier and Embraer inch towards entering the large aircraft market. As these industries and markets grow, the U.S. government and its European counterparts must take the lessons learned from their heated competition in recent years and work with these nations to build certainty and safety into the global marketplace.

The focus of this hearing is on the Department of Commerce report on *The U.S. Jet Transport Industry: Competition, Regulation, and Global Market Factors Affecting U.S. Producers*, mandated by § 819 of Vision 100. While I appreciate the work that the Commerce Department has put into this report, I think that the report should be viewed in light of DOC's strategic goal to "provide the information and tools to maximize U.S. competitiveness and enable economic growth for American industries, workers, and consumers."

The DOC report discusses a range of topics, including: trade policy; launch aid and aircraft certification. On safety issues, the DOC report cites several instances where European regulatory decisions have been perceived as anticompetitive, without making an effort to determine whether any of those regulatory determinations were based on *legitimate* safety concerns. We must be careful before making such serious accusations, as legitimate concerns regarding safety should be encouraged and could serve to enhance the safety of a particular product. Even the DOC report notes that "there is no evidence of widespread manipulation of safety or airworthiness certification processes to achieve competitive goals."

However, the U.S. should continue to press for the harmonization of certification and validation processes to ensure that there are no opportunities for trade barriers to surface under the guise of conflicting regulatory procedures. Moreover, the U.S. must respond strongly when protectionist measures are imposed on U.S. manufacturers, as we did in 1999, when the European Union (EU) passed a measure imposing restrictions on the use and sale of hushkitted or re-engined aircraft. I have no doubt that many supporters of these restrictions believed that they would reduce aircraft noise. However, it quickly became apparent that any limited noise reductions achieved would come primarily from limitations on aircraft, engines, and technology developed by U.S. companies, with no limitations on comparable European products, some of which create more noise than the U.S. products that are

banned. I, and many of my colleagues, fought hard to have this measure struck down, and it was.

We must also tackle the most significant impediment to the future of the U.S. large civil aircraft manufacturing industry – the lack of adequate funding for basic R&D to address environmental concerns. The National Aeronautics & Space Administration's research budget has steadily declined over the last decade from a high of $1.54 billion in FY94 to the FY06 budget request of $852 million. The importance of well-funded U.S. research to reduce aircraft noise and emissions cannot be overstated. We must act now to preserve NASA's vital research programs to ensure a healthy and robust U.S. aeronautical industry that will meet the demands of the market as well as the needs of communities here at home and abroad.

I look forward to hearing from the witnesses' testimony on competition in the aircraft manufacturing industry.

Statement by Representative Ellen Tauscher
Aviation Subcommittee Hearing
Wednesday, May 25, 2005

Thank you for the time, Mr. Chairman.

As Congress and this Committee continue to address the health of our nation's airline industry, it is of particular importance that we also review the health of U.S. aircraft manufacturers.

More so now than ever, we have asked American businesses to compete in the world market, with the confidence that if given a level playing field, they will be able to thrive despite increased competition.

The result, we hope, will be better products; faster service; an opportunity for increased revenue and expansion; and, ultimately, a better marketplace for consumers.

Of course, Mr. Chairman, all of this, as I have already indicated, is predicated on the existence of a level playing field.

The Commerce Department's report confirms what many of us already knew – the playing field in the global aircraft manufacturing market is skewed now and has been skewed for some time.

In late 2004, many of us here wrote to United States Trade Representative Zoellick and asked him to take action to this address anti-competitive behavior in the market.

In essence, we asked him to level the playing field.

We must continue to pursue this effort because we risk losing the advantages of free and fair trade by not demanding that our partners act with us in good faith for the health of the global market.

That being said, Mr. Chairman, I believe we will have missed an important opportunity if today's hearing does not examine the choices we are making here at home that affect the competitiveness of American manufacturing.

Domestically we have dramatically scaled back our commitment to aeronautics research and development, to our own detriment.

For decades, the hallmark of our nation has been our commitment to discovery, our people's ingenuity and our government's promise of financial support to keep the research engine burning.

I don't doubt the American people's ingenuity or their commitment to new discovery, but in recent years, Mr. Chairman, we have failed to live up to our promise.

If we are to continue to be the nation of technological advancement, than we must make a stronger commitment to fund a robust national research and development program.

The footsteps we hear behind us are the rest of the world and they are catching up.

If we expect American businesses to remain global leaders, than our nation and this Congress must exhibit some leadership.

Mr. Chairman, I look forward to today's hearing and to a conversation which covers not only the global factors affecting our markets but the domestic ones as well.

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