

**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.

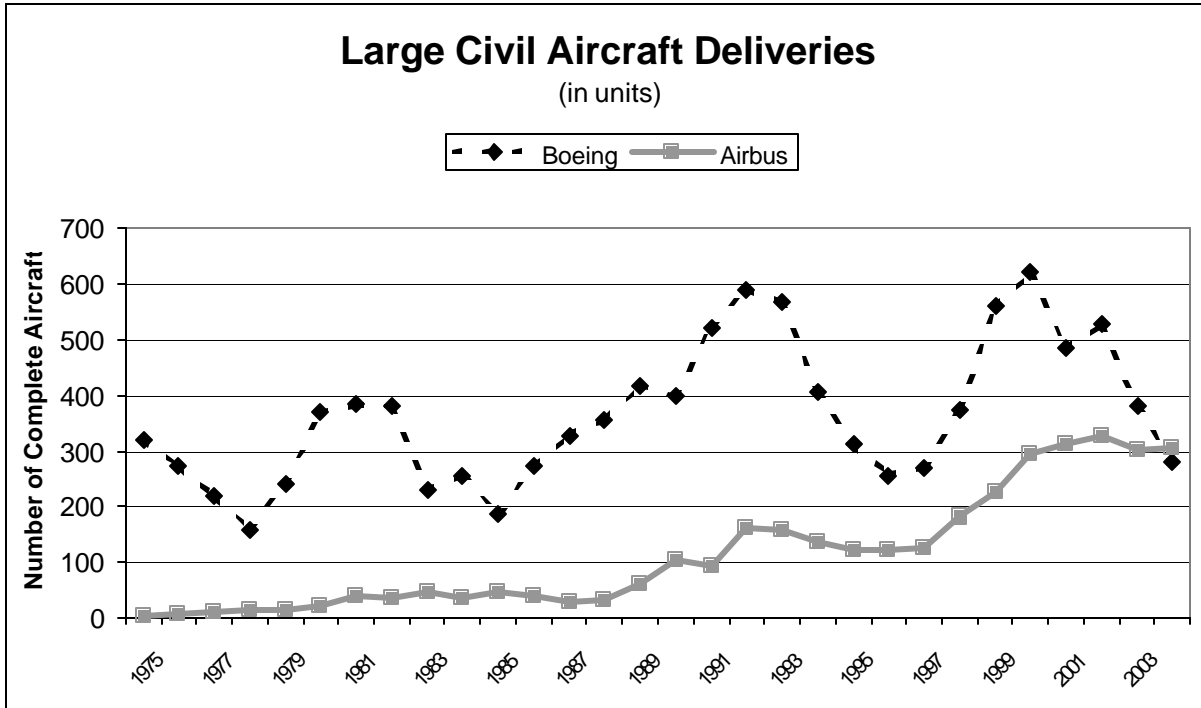
This request provided a unique opportunity to undertake a comprehensive, strategic assessment of the competitiveness of the global commercial airline and jet transport manufacturing industries, to review the many international trade agreements and provisions that directly affect those industries, and 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.

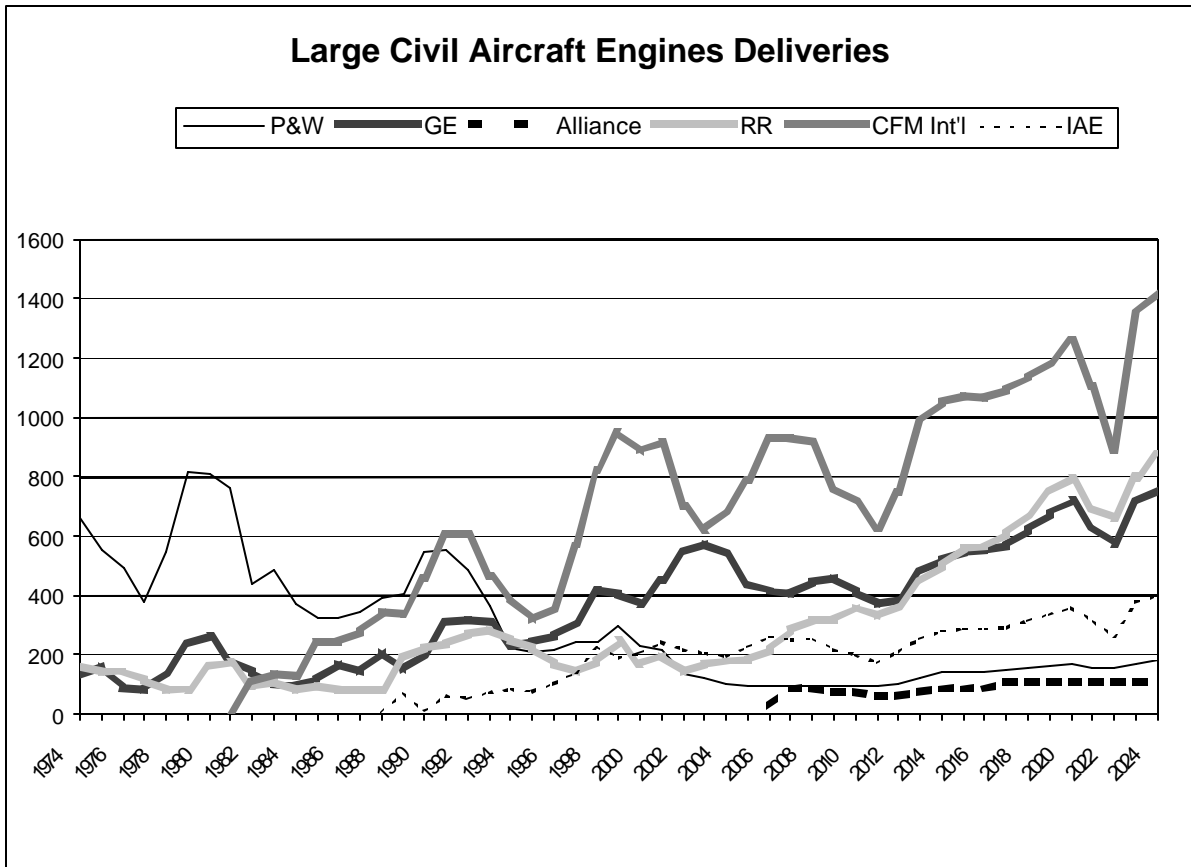
A number of other departments and agencies were instrumental in our development of the report. We consulted with experts in the Departments of Transportation, Justice, Homeland Security, Labor, State, and Treasury; the Federal Aviation Administration; the National Aeronautics and Space Administration; 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.



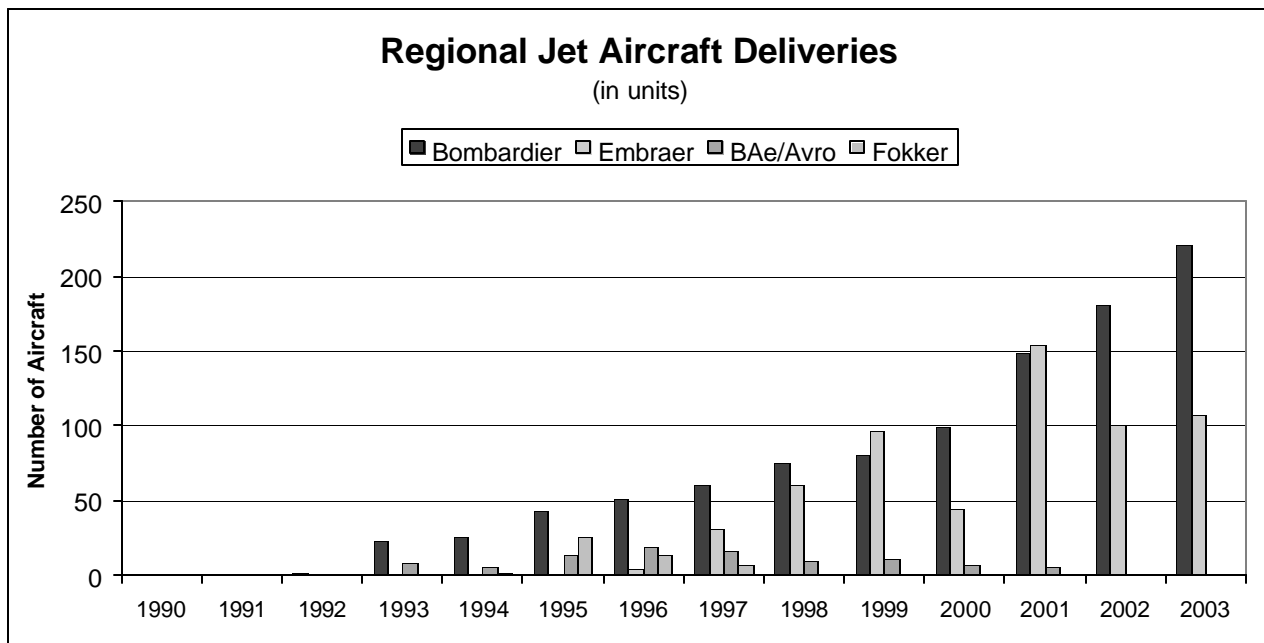
Source: U.S. Department of Commerce analysis of Boeing, Airbus data



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.

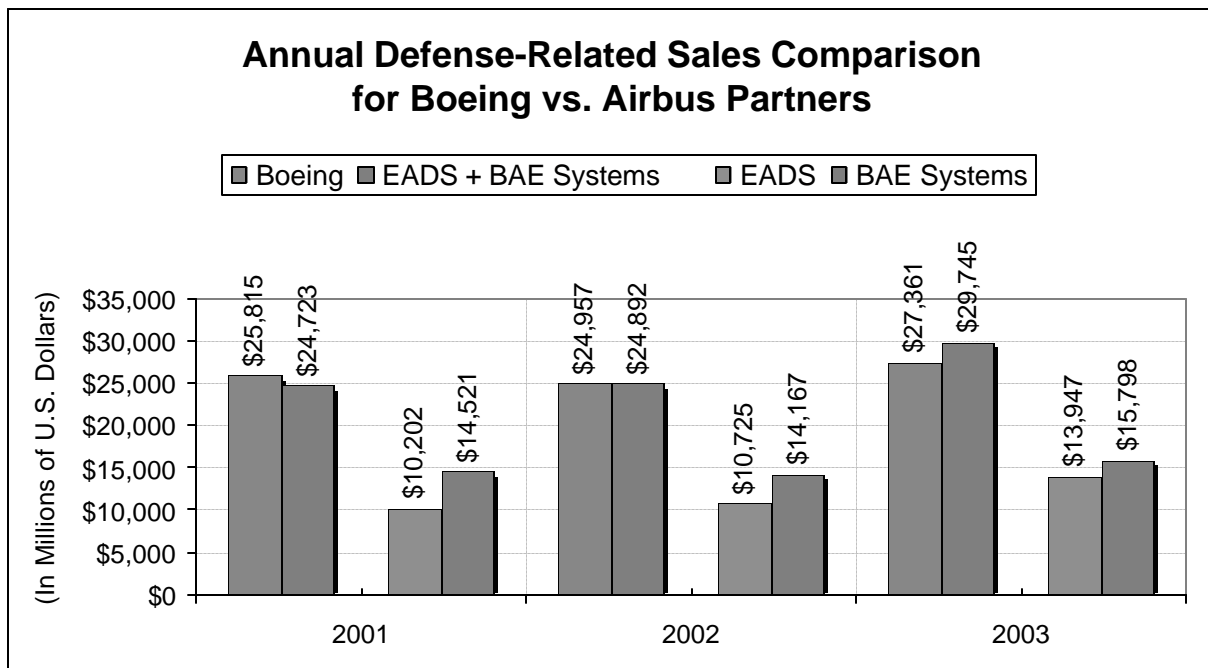
The U.S. government invests public R&D money in development of long-term breakthrough technologies that benefit the public. European governments also invest in basic technology advances, although this funding often is intended to develop new products for near-term application in the large civil aircraft 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.