

**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**

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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
<i>1993 Boeing</i>	<i>330</i>	<i>4</i>	<i>\$20.6 billion</i>	<i>75,000</i>
2004 Airbus	320	12	\$25.1 billion	51,959
<i>2004 Boeing</i>	<i>283</i>	<i>7</i>	<i>\$21 billion</i>	<i>52,669</i>

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 1970², Airbus has benefited from a total of \$15 billion in launch aid, including \$3.2 billion³ 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 billion⁴, 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.

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.