

**Testimony of
Joseph V. Kennedy
Senior Fellow
Information Technology and Innovation Foundation**

**Before the
United States Trade Representative's Office**

**Hearing on
"Enforcement of U.S. WTO Rights in Large Civil Aircraft Dispute"
Docket No. USTR-2019-0003**

May 16, 2019
Washington, DC

The Information Technology and Innovation Foundation (ITIF) is pleased to provide testimony pertinent to the United States Trade Representative Office's (USTR's) investigation to enforce U.S. rights regarding the United States' World Trade Organization (WTO) dispute against the European Union (EU) and certain member states regarding their subsidies for the development and launch of large civil aircraft. ITIF endorses USTR's proposed imposition of countermeasures, in the form of additional tariffs, commensurate with what the WTO's Dispute Settlement Body has found to be adverse effects inflicted on U.S. aerospace competitors as a result of the EU's WTO-inconsistent subsidy programs for large civil aircraft.¹

The United States has contested EU subsidies to Airbus at the WTO since 2004, with the WTO finding in 2011 that 80 percent of alleged improper subsidies given to Airbus were in fact illegal and that the EU provided \$18 billion in total subsidized financing to Airbus from 1986 to 2006.² The WTO found at the time that European subsidies were instrumental in enabling Airbus to launch every single model of its large civil aircraft, causing Boeing to lose sales of over 300 aircraft, and global market share, over this period.

Yet instead of removing its subsidies and discontinuing their use, the EU has continued to apply them. In 2018, the WTO found that the EU breached its WTO obligations by providing at least \$9 billion in subsidized financing to launch its two largest civil aircraft, the Airbus A380 and A350 WXB.³ (In 2016, the WTO concluded that the total amount of WTO-inconsistent subsidies provided to Airbus by the EU and its member states had exceeded \$22 billion). The United States has estimated the harm from the EU subsidies as totaling \$11 billion each year and a WTO arbitrator is currently evaluating a U.S. request for annual countermeasures.

The European Union and its member states' provision of launch aid—highly subsidized loans intended to facilitate the development of new products—to Airbus represents an insidious form of industrial subsidization that significantly distorts global markets and injures foreign competitors. The launch aid has allowed Airbus to secure financing on better-than-commercially available terms (i.e., at financing rates better than readily available in commercial markets). Moreover, repayment terms on the loans are often tied to aircraft delivery targets, meaning repayment doesn't begin until a number of years after a product's launch. Further, the loans have included terms that if a product failed to hit pre-determined sales targets, remaining loans on the product would be forgiven.⁴

The prosecution—and ultimate resolution—of this ongoing dispute with the European Union is highly consequential to the future of the U.S. innovation economy and to the broader global economic and trade system. That's because innovation-based industries—such as aerospace—fundamentally compete by introducing new-to-the-world products yet face very high upfront fixed costs of design and research and development (R&D). For instance, analysts have estimated the development costs of the Boeing 787 Dreamliner as exceeding \$32 billion.⁵ Innovation-based companies must amortize these development costs across large global markets in which they must be allowed to equitably compete. Moreover, innovative enterprises depend upon profits earned from one generation of innovation to finance investment in the next, for they must innovate for the future, which is why the U.S. aerospace industry devotes 8.5 percent of its revenues to R&D annually.⁶

However, when countries introduce excess, non-market-based competition into the global economy—such as by subsidizing domestic producers—it introduces non-economic-based competition that distorts global markets and substantially harms enterprises which attempt to compete on market-based terms. This excess competition enables weaker firms—or the products of weaker firms—to remain in the market, drawing off sales from stronger firms and so depriving them of financial resources needed to invest in future generations of innovation (i.e., the next major aircraft innovations).⁷ But not only do subsidies like launch aid decrease costs (by offering financing on better than commercial terms), thus giving a competitor like Airbus a cost advantage, it also enables Airbus to introduce new products faster than it would be able to do so otherwise, thus giving the company an advantage not just on price but also on time-to-market.

Yet the implications of this dispute go far beyond Airbus and Boeing, for the resolution of this conflict will frame the rules of the road and set norms for competition in the development of advanced technologies that are being closely watched by other nations. For instance, China has subsidized its technology sectors to the tune of hundreds of billions of dollars. In the 2000s, China provided almost \$100 billion in subsidies to just three industries alone: auto parts, steel, and paper.⁸ It's followed this up with \$160 billion in subsidies as part of its National Integrated Circuit Strategy which seeks to create a completely closed-loop semiconductor industry that precludes the need for foreign imports by 2035.⁹ Similarly, the Commercial Aircraft Corporation of China (Comac), the state-owned Chinese commercial aircraft company, benefits from a wide array of mercantilist policies including forced technology transfer in exchange for market access, massive subsidies, and discriminatory procurement.¹⁰ For instance, Comac started with \$2.8 billion in capital from the central government and became eligible for a \$4.4 billion line of subsidized credit from Chinese state-owned banks.¹¹ Going forward, China's extreme subsidization is likely to touch virtually every advanced-technology industry: China's "Made in China 2025 Strategy" is supported by some 800 state-guided funds to the tune of more than \$350 billion, including for advanced-battery manufacturing, wide-body aircraft, and robotics.¹²

Such subsidization of advanced-technology industries substantially distorts global markets in innovation-based industries. It's time for WTO member nations to remove these practices to preserve a rules-based international trade system that provides a level global playing field in which enterprises compete through genuine innovation with their products and services consumed on a best-value basis.

The consequences for the U.S. economy are significant, as the U.S. aerospace industry is one of America's most important. In 2016, the sector's gross domestic output totaled \$266.5 billion.¹³ In 2017, the aerospace industry contributed \$143 billion in export sales, recording a trade surplus of nearly \$85 billion that year, which was the largest trade surplus of any manufacturing industry.¹⁴ In 2018, the sector employed 485,790 Americans, earning a mean wage \$83,470.¹⁵ Moreover, large OEMs in the sector like Boeing are the lynchpin of sprawling industrial supply chains that constitute the backbone of America's industrial economy; Boeing for instance works with 13,000 suppliers from across all 50 U.S. states.¹⁶ The EU's use of WTO-inconsistent subsidies supporting the development and launch of large civil aircraft has substantially harmed the competitiveness and economic welfare of U.S. aerospace enterprises and industries and their workforces.

ITIF endorses USTR's proposed imposition of countermeasures, in the form of additional tariffs, commensurate with the extent of injury inflicted by the EU's WTO-inconsistent subsidies. To the largest extent possible, additional duties should be placed on goods from industries that have been most-directly affected by the EU's launch-aid practices. Goods falling under four-level harmonized tariff categories such as 8802 and 8803, pertaining to goods such as new aircraft, new helicopters, and undercarriages and fuselages, are the most-appropriate targets for the imposition of additional duties. However, it is important that USTR refrain from introducing additional duties on productivity- and innovation-enhancing capital goods such as information and communications technologies (ICTs). As ITIF has demonstrated, there exists a strong correlation between the ICT capital stock of a nation and its long-term economic growth potential.¹⁷ Increasing tariffs on ICTs increases their prices, which lowers their consumption and adoption, which thus stifles a country's long-term economic growth prospects.

Global consumer and economic welfare is maximized when nations embrace private-enterprise led, market-based, and rules-governed commerce. USTR's proposed countermeasures represent an appropriate redress to continued EU implementation of WTO-inconsistent industrial support measures. Ideally, it's an important step toward prevailing upon the EU and its member states to abandon this practice and to return to the norms and standards of WTO-governed, rules-based trade in which Europe professes to generally adhere.

REFERENCES

1. Office of the United States Trade Representative, "Initiation of Investigation; Notice of Hearing and Request for Public Comments: Enforcement of U.S. WTO Rights in Large Civil Aircraft Dispute" *Federal Register* Vol. 84, No. 71, April 12, 2019.
2. Loren Thompson, "WTO Rules U.S. In Compliance With Trade Rules While Europe's Airbus Relies on Illegal Subsidies," *Forbes*, June 9, 2017, <https://www.forbes.com/sites/lorenthompson/2017/06/09/wto-rules-u-s-in-compliance-with-trade-rules-while-europes-airbus-relies-on-illegal-subsidies/#5b5d44b6160e>.
3. Office of the United States Trade Representative, "WTO Rejects Claims That U.S. Provides Subsidies Comparable to Massive EU Aircraft Subsidies" news release, March 8, 2019, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/march/wto-rejects-claims-us-provides>.
4. Boeing, "Facts About Airbus Subsidies," <http://www.boeing.com/company/key-orgs/government-operations/wto.page>.
5. Dominic Gates, "Boeing celebrates 787 delivery as program's costs top \$32 billion," *Seattle Times*, September 24, 2011, <https://www.seattletimes.com/business/boeing-celebrates-787-delivery-as-programs-costs-top-32-billion/>.
6. National Science Board, *Science and Engineering Indicators 2018*, "Table 4:10 Sales and R&D intensity for companies that performed or funded R&D, by selected industry: 2015," (National Science Board, 2018), <https://www.nsf.gov/statistics/2018/nsb20181/report/sections/research-and-development-u-s-trends-and-international-comparisons/u-s-business-r-d>.
7. Robert D. Atkinson, "Why More Aircraft Competition Is Bad for the U.S. Economy, Not Good for Consumers," *Innovation Files*, May 1, 2018, <https://itif.org/publications/2018/05/01/why-more-aircraft-competition-bad-us-economy-not-good-consumers>.

8. Usha C.V. Haley and George T. Haley, *Subsidies to Chinese Industry: State Capitalism, Business Strategy, and Trade Policy* (Oxford University Press: 1st edition, 2013).
9. Stephen Ezell, “China-Induced Global Overcapacity an Increasing Threat to High-Tech Industries,” (Information Technology and Innovation Foundation, February 2018), <https://itif.org/publications/2018/02/27/china-induced-global-overcapacity-increasing-threat-high-tech-industries>.
10. Robert D. Atkinson, “Designing a Global Trading System to Maximize Innovation,” *Global Policy*, February 24, 2014, <https://onlinelibrary.wiley.com/doi/pdf/10.1111/1758-5899.12120>.
11. Atkinson, “Why More Aircraft Competition Is Bad for the U.S. Economy, Not Good for Consumers.”
12. Robert D. Atkinson, “Testimony Before the Senate Committee on Foreign Relations: Hearing on A Multilateral and Strategic Response to International Predatory Economic Practices” May 9, 2018, <http://www2.itif.org/2018-strategic-response-international-predatory-economic-practices.pdf>.
13. Bureau of Labor Statistics, Industry Output and Employment (domestic industry output; accessed May 10, 2019), <https://www.bls.gov/emp/data/industry-out-and-emp.htm>.
14. Select USA, “The Aerospace Industry in the United States,” <https://www.selectusa.gov/aerospace-industry-united-states>.
15. Bureau of Labor Statistics, Occupational Employment Statistics (employment, annual mean wage, annual median wage; accessed May 10, 2019), <https://www.bls.gov/oes/>.
16. Boeing, “Boeing Honors Suppliers for Outstanding Performance,” news release, April 12, 2018, <https://boeing.mediaroom.com/2018-04-12-Boeing-Honors-Suppliers-for-Outstanding-Performance>.
17. Stephen Ezell and John Wu, “How Joining the Information Technology Agreement Spurs Growth in Developing Nations” (ITIF, May 2017), <https://itif.org/publications/2017/05/22/how-joining-information-technology-agreement-spurs-growth-developing-nations>.