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"THE BOEING-AIRBUS TRADE DISPUTE:
IMPLICATIONS FOR TRANSATLANTIC RELATIONS
AND GLOBAL TRADE"

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P A R T I C I P A N T S

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P R O C E E D I N G S

MS. BRAINARD: Good morning, everybody. We are delighted you could be here. We have configured the room, so that you can kind of get a feeling for the new Dreamliner, and if you can't hear us in the way, way back, just stand up and let us know.

We are here to talk about the Boeing-Airbus dispute, and Jeremy Shapiro, who set this up, I think has an inside line to USTR because he timed it just about perfectly. There is a lot of news on this front.

What I will do is introduce each panelist in turn and ask them a few questions and then open it up for a broader discussion with the audience.

So I want to start with Gene Gholz. Gene Gholz is joining the LBJ School of Public Affairs at the University of Texas-Austin, and he is currently at the Patterson School of Diplomacy and International Commerce at the University of Kentucky.

I know him from our days together at MIT, and his research is squarely in this area, how the government decides what to subsidize in the arena associated with both commercial and military technology and from both a political science and an economic point of view.

I want to start with Eugene because I wanted you to give us the basic story line here. Why is the U.S. challenging Airbus subsidies

now? Didn't we sign an agreement back in 1992? So what is different now?

MR. GHOLZ: Well, thank you for having me here, and the kind introduction.

What is different now is in some ways a simple question and in some ways a difficult question. You mentioned the 787 Dreamliner, the new Boeing airplane that they are just getting into development for, in your opening remarks joking about the room. I think the Dreamliner is meant to be a sleeker-cabin configuration, and this looks like the old-fashioned cattle cars. So I don't know, but Boeing would not be happy with your description.

What is different now in a sense is that there is a new airplane about to come out. That is actually kind of true on both sides of the Atlantic. The Europeans are in between two new airplanes. The A-380 has just had its first flight, and they are winding up to start another new project, the A-350. In a sense, I said there is nothing new earlier, and that is because we have had this exact same situation many times in the past.

I think what you see is the trade dispute heats up every time each side is ready to launch a new airplane, and so we went through a round of this in the early '90s with 777 and the A-330 and A-340. There was a round of trade dispute before that with the Airbus 310, roughly, when airlines in the United States were thinking about buying an Airbus

product for the first time, since none of them, after playing footsy with the Europeans on the A-300, kind of that no one wanted that in the early days in the United States.

Every time each side is ready to launch a new aircraft, the trade dispute comes back because they think they can gain leverage. Launching a new aircraft is so high risk, there are so many different things that you would like to control that you can't, the companies on both sides just try everything, and that means trade dispute. It means advertising. It means sales campaigns, talking to all the airlines. It means risk-sharing partnerships with subcontractors. I mean, there is nothing new. It is every time there is another round of development risk, there is another round of trade dispute.

MS. BRAINARD: Let me now turn to our European participant. All of the participants, I should say, here are here in a personal capacity and not representing official points of view.

Hugo Paemen, I am sure you are all familiar with him. He has served in Washington for many years in a very distinguished capacity as the European Commission's Washington Delegation Head and from 1987 to 1995 as the European Commission's Deputy Director General where he was deeply involved in the negotiation of the Uruguay Round where we found the first aircraft agreement that is now very much up in the air.

Hugo, I wanted to ask you about the logic. The EU just won last year an absolutely path-breaking case against U.S. subsidies. What is the logic for the EU now to be defending subsidies for a particular industry, the aircraft industry, where it now has more than 50-percent share?

MR. PAEMEN: Well, first of all, I am happy to be here.

As you said, I am speaking in my personal capacity. I have no links anymore with any government, with any European institution, and with any industry. This being said, I have my past, as you said, and I also negotiated for the agreement in 1992 which took 2 years, as probably some of you remember.

Why the Europeans still want to have subsidies? Because we would prefer to have no subsidies, as everybody is in favor of not having subsidies in principle. In reality, I think the nature of the industry is such that governments will be involved in this sector, whatever we want.

Governments have been involved from the very beginning, from the time there were only three producers of large civil aircraft, and the three were American. Then during that period, as well in Japan, but even more in Europe, there was this will to have desire to have an aircraft industry, and then with a lot of subsidies, it took off the ground until there was disagreement because the United States thought that now

Airbus should be brought within certain limits as far as the disciplines and subsidies are concerned, and that led to the 1992.

But as I said, because of the economic importance, because of the strategic links, because of the military links, because of the growing regulations in terms of safety, environment, there will always be government involvement, and also because of, one can say, this nearly identical in technological basis for aircraft. Whether they are military, whether they are civil, there is no doubt that there will always be government involvement. The question is how can we discipline and how can governments agree where the limits are and what the rules of the game are. That was the purpose of the agreement in 1992, and it stayed with us for about 13 years, which means it was not that bad of an agreement, but it is clear time has come to review it, to change it, and that was also what was said when we signed the Subsidy Code in the context of the Uruguay Round. It was explicitly said that there would be multilateral talks about the sector of aircraft.

They haven't taken place yet, but I hope they will take place very soon, and perhaps in the same kind of mood as we did it in 1992 which was a little bit nicer, I think, than it was today, but that is because it is perhaps far away.

MS. BRAINARD: Let me just ask you one other question before we go on. We are reading this morning that the introduction of

the A-380 has now been pushed back. It seems like a bad week for Airbus. Is Airbus in trouble, or is this just a glitch?

MR. PAEMEN: No idea. As I said, I have no links with Airbus.

It is not the first time that airplanes are launched at a certain date as put forward. That is part of the tactics. You have to announce so that the competitor is somewhat scared about you and then you can't deliver on the date. I think that has happened in the past. I wouldn't dramatize this too much.

This being said, there are two different strategies involved here. That is absolutely clear. It is the strategy of the big airplane that brings the passengers to where they want to be, and that is the Airbus strategy. The big airplane, of course, is the hub function; the small airplanes bring the passenger where they want to be. And that's a bet, and I think nobody knows exactly who is going to win. That is the difficulty, and that is part of the risk that was mentioned before.

What strikes me most, having dealt a little bit with this sector, is the enormous problem of the risk management of this sector, and it is very interesting to see how the risk management has changed over time. Risk management is partly done by the companies, but for the reasons I mentioned before, it is also part of the government. It is also part of policy.

It is interesting. The 787 has a completely different risk management approach than the planes had when, as I said, there were only three LCA producers and they were all three American. That was a time when the 707 was safe because there were military tankers involved. That was a time when even the 747 was totally funded, as far as the development cost is concerned, by the government because it was part of a bid to replace the C-5, and they are still flying today.

So you see all this, we are still living with a certain concept of risk management of the past, which is no longer the type of risk management which as well as Airbus has, by the way, as Boeing will have to conduct in the present circumstances, which is a circumstance of globalization, global risk, and also global customers and global producers.

MS. BRAINARD: I am going to get to Bruce in a second on the politics, but I first just wanted to go back to Gene on this question. I think John Newhouse was perhaps the first to coin the phrase "betting the company," talking about just how enormous the bets that these aircraft manufacturers take with each new model.

Gene, is Hugo right? Do we simply have different mechanisms of socializing risk? The Europeans do it directly through taxpayer subsidies, the U.S. does it indirectly through defense industry, or has the world become more complicated than that?

MR. GHOLZ: Well, I am not sure the world has become more complicated than that. I don't think that was true in the past.

In fact, I would make almost exactly the opposite argument, which is that the U.S. side, Boeing is doing that more now, which I think is a mistake, and prior to 1997, Boeing did very little in the way of getting benefits from this sort of military spin-off to socialize risk.

There is a huge amount of risk to deal with. Companies don't like to bear that much risk by themselves. They may not be able to do at all. It may actually be the case that companies just couldn't do this. It might be that with kind of fancy derivative instruments and things like that, that we have today, financial markets have gotten better at bearing risk. So maybe you could do it now. I don't know. We will run that social science experiment in the next few years.

I guess my understanding of the history, having done quite a bit of work in this, is different than Hugo's. I don't think the 707 and the 747 are military-derived aircraft to the extent that the military paid for the development of these aircraft.

There are bits and pieces, and it goes back and forth, and there is lot of countervailing evidence in this. I can talk about this in way more detail than anybody care's about is the truth. The 747 is not the same plane as the C-5. Boeing didn't get paid to design the 747. Lockheed won the C-5 contract. If there was a great benefit from the

military socializing risk, Lockheed's L-1011 should have been the great aircraft of the 1970's that had a low-risk profile.

Instead, Lockheed got hammered, lost a truckload of money. Boeing didn't have any military aircraft contracts at the time of the 747 development. They had some military space launch business, but the 747 looks a lot different than rockets, strategic missiles, these kinds of things that Boeing was actually building.

I think it is very hard to make that historical case, but now let me say one other thing about this, which is the current trade dispute, there is this funny tension. People like to point fingers and tell stories about the past and they like to say "Oh, Boeing benefited, so we should subsidize" or "The Europeans got launched, so we need help on our side of the Atlantic." In fact, a lot of the analysis that goes into WTO cases is backward-looking analysis. You have to show that you have been harmed in the past in order to win a WTO judgment.

What the companies are mostly interested in and what the governments say they want in the negotiations is all but Hugo was saying. They want to discipline on subsidies in the future, and basically, the WTO case, if the panel decision goes forward and somebody wins or loses, it can't provide the discipline on the future. It is a backward-looking thing. It is assessing what has happened in the past, did someone violate rules in the past, and should there be penalties or should someone have to pay back subsidies or be asked to pay back subsidies.

If we really want to have discipline and different ways of deciding how to socialize risk, that has to happen through negotiations, not through the WTO case.

In a sense, what the companies are saying is we would like to wash our hands of all the fight about the past. Tempers get high. It is very emotional. It is hard to sort out the past. People like Gholz write hundreds of pages about this. It is not that interesting to read.

Let's just figure out the future. Let's agree not to have subsidies or to discipline subsidies in the future is what people want to do going afford.

MS. BRAINARD: Let me bring in Bruce Stokes. I am sure we can get back on some of these points, Hugo, if you want to come back on them.

Bruce, as most of you probably already know, is the International Economics columnist for the National Journal and is also a Fellow with the German Marshall Fund and with the Pew Research Center where he works on the Global Attitudes Project. We hear his voice frequently on things like Marketplace and NPR, among others.

Bruce, I wanted to ask you to kind of take us back a step and look at the political context, a big trade dispute going into a very important meeting in Europe in July, Gleneagles G8 Summit, a lot riding on U.S.-European Relations, and then, of course, later in the year, the next big ministerial for the Doha process, a lot of hot tempers, as Gene

was saying, between already the new U.S. trade negotiator and the new EU trade negotiator.

What is going to be the fallout here, and separately, is there any fallout from the French "non" vote in terms of how the EU is likely to be making decisions on trade going forward?

MR. STOKES: Thanks, Lael. It is a pleasure to be here.

Why don't I take the second question first since that is the most immediate. It seems to me that the real danger in terms of internal European decision-making is that the adults will be otherwise occupied and that this case will proceed under the direction of the trade bureaucrats in Brussels who may or may not be that in touch with the broader set of issues in the relationship. They are pursuing their portfolio, their agenda. There are, in fact, some very aggressive trade bureaucrats in Brussels who have wanted to stick it to the United States on this issue for a long time.

We should not forget the FISC, the tax dispute that we had with the Europeans, which really got out of hand because there were no adults present to kind of make a decision early on that this was not a road neither one of us wanted to go down. It is still a lingering problem in the relationship years later.

So I think the biggest problem could be, at least in the short run, that those who have a broader vision, the elected leaders, may be preoccupied, and that this case might gain momentum and the animosity

might build. The back-and-forth may get worse before the political leaders step in.

There is another problem, though, it seems to me domestically in Europe, and that is at the national level, you have a series of national political problems which may or may not run counter to an easy solution to this problem.

You have got Tony Blair who is, more or less, a lame duck. You have Jacques Chirac who is severely wounded, if not mortally wounded. You have got Schroeder who will probably be out in the fall and preoccupied certainly between now and then with his own election campaign.

You have very bad economic circumstances in many parts of Europe and a disgruntled electorate certainly in Germany and France.

These programs that benefit from these subsidies are great pork barrel in Britain, France, and Germany in particular. In the political circumstances that now exist in Europe over the next few months, if not longer, it does seem to me that we may be expecting a lot to assume that domestic politicians could somehow bite the bullet and say no, we are going to give up these subsidies, and believe me, these won't cost us jobs and somehow hurt the local economy around Toulouse or the local economy in Wales or whatever. I think that is a major, major difficulty and will continue to be a difficult as long as Europe is in the doldrums economically.

Let's face it. Airbus is one of the few competitive success stories in Europe. So, again, it is hard politically to stand up and argue. We can say that they don't need this anymore, they are now competitive. They can say it is competitive because we subsidized and we aren't about to kill this goose that has been laying some of the few golden eggs.

So, domestically, it is going to be hard I think in the short run to make some decisions around this. Internationally, I think we probably shouldn't overblow this.

I think that the real problem is at the G8 Summit. The real Transatlantic tensions, frictions, difficulties will arise out of the continued animosity among the public in Europe towards George Bush and towards U.S. policy in general, the declining support for the war on terrorism, a series of issues where the U.S. will be pushing for more European aid or help or assistance, and weak European politicians seeing very little value in siding themselves with George Bush when their populations are disgruntled with this relationship.

I think that none of us should believe the spin that will come out of the White House over the next week or so, 2 weeks, in the run-up to the Summit that they somehow turned a corner in their transatlantic relationship with the Europeans. I think there is absolutely no evidence of that other than a few pronouncements by the elites in Europe who are engaged, I think, in wishful thinking, but I think that in general, things

haven't changed on the ground and this French election and the upcoming German election will bear that out I think and support that.

Finally, in the Doha Round, I think the Doha Round will sink or swim of its own weight. It is a very troubled negotiation, as many of you in the audience know. It faces real difficulties on time tables and deliverables.

It is conceivable that Airbus could become an excuse for part of the failure, but I don't think it will be the reason.

Now, it is interesting to note that we are now about to begin about an 18-month process in the WTO. That would bring us to about the end of 2006. That is notionally the end of the Doha Round, where at the end of 2006, we may be hustling to cobble together some kind of agreement and call it a victory in the Doha Round.

It is not beyond the possibility that smart people like Bob Zoelick were cognizant of this fact when they began to pursue this case, realized it would be nice to have yet another chit on the table to bargain with when they are trying to strike a deal at the end of the day.

There is an array of other reasons, much more important commercial reasons why this case was filed, but I do think that the timing is interesting and could actually become a part of the end game of the Doha Round.

MS. BRAINARD: Let me just ask Hugo also to comment on the political fallout in Europe and then open it up to the audience.

MR. PAEMEN: The political fallout of the election?

MS. BRAINARD: No. Of the "non" vote in France and the general political—of the referendum, yes.

MR. PAEMEN: Well, it is clearly perceived as a serious setback for, I would say, the political establishment in the two countries, in France and in The Netherlands.

In France, the president was in favor. His majority party was in favor. The opposite party was in favor. The green party was in favor. You wonder how he could lose a referendum which, by the way, he was not obliged to organize. So it is clearly a populist revolt against what the political establishment had been saying.

It happened that it concentrated on the European referendum because that was the opportunity for the population to express its dissatisfaction and its frustration, but there is certainly an element of nervousness about what happens in Europe; for instance, in terms of services.

There was this services directive, and there was this idea that suddenly France would be inundated by hairdressers from Poland and all this. That was very nicely exploited by those who were against the so-called "constitution," which was, by the way, not a constitution. As you all know, it was simply a treaty.

In Holland, it had certainly much more to do with the immigration issue, with the quite painful events which had taken place

with this politician that had been murdered and so on, and again, it was clearly and it was sad and it came out of all the opinion polls, it was a revolt against the existing political establishment, which is a serious problem because there also you had a quite solid majority in the parliament, and the whole establishment was in favor. There, the people say no.

So I think, as Tony Blair said, we need a serious moment of reflection on how we have to interpret this and how we will react to it.

Now, the real percussion of all that on the ongoing things, my feeling is it is not going to be very important. I don't know whether that is good or bad.

First of all, the reaction was not against the substance of the constitution. Most people didn't know very well what it was all about.

Secondly, there was not that much substantial innovation in the so-called "constitution."

And thirdly, what is going on in terms of what we are discussing here, the Doha Round and so on, it is a somewhat different constituency, which by the way, as Bruce said, is not very motivated, but that is for a different reason. It has nothing to do with the European integration.

I think, and I agree with Bruce, that overall the Doha Round is not in good shape because nowhere in the world there is a strong constituency in favor of the Doha Round. A lot of countries, a lot of

governments, and the one where we are seem to prefer much more bilateral agreements.

The business community, as far as I can judge, doesn't feel very strongly about going into a new, big, multilateral negotiation. They think they can settle their problems by going straight to where they think the decisions are being made, rather than going to Geneva and having 150 countries trying to agree on something.

It was in not so good shape before the referendum, and it is still in not so good shape today. So I don't think that is a great difference.

MS. BRAINARD: Well, I have to say with reference to Hugo's mention of the concern about hairdressers from Poland, having had many of my early childhood haircuts in Poland, I can understand the no vote now.

[Laughter.]

MS. BRAINARD: Let me ask anybody who has a question to stand, to identify yourself, and to wait for a microphone. Thank you.

MR. BACKFISCH: Michael Backfisch, Germany's Business Daily, Handelsblatt.

According to the bilateral agreement of the U.S. and the EU from 1992, Airbus was allowed to receive subsidies for research and development of up to 33 percent.

Why finally did the U.S. cancel that deal in 2004? Was it simply related to the competition field that Airbus has caught up on the world market, or are there other reasons?

MR. GHOLZ: Well, the public story that Airbus has caught up and gained a lot of market share and so no longer needs an infant industry subsidy is a very powerful political chit. It plays well, and so that makes it easier to say okay, last time we talked about getting rid of launch aid, we reached an agreement.

Actually, in the lead-up, Hugo obviously knows much more about this than I do, but in the lead-up to the previous agreement, the United States quickly went to a 25-percent cap as our negotiating position. We weren't trying to go for zero, and we compromised at the 33-percent level.

Now it looks easy to say you don't need any subsidy anymore, you are a market share leader. Maybe you would trade back and forth leadership. Some people, not Airbus, but many other people are predicting that Boeing will have market share leadership again this year.

I think this is a bit of a red herring argument because I think that there are lots of other reasons why either politically, as Bruce was talking about, or actually from an economic perspective you might want to subsidize the aircraft industry, besides infant industry protection.

If you were thinking about why you wanted to do this, lots of economists think that companies don't invest enough in R&D left to their own devices because they are afraid of spillovers. They are afraid if they invent something, other people will also gain the benefit of their R&D investment because they will see the new product and be able to copy it.

Especially nowadays, as Hugo mentioned earlier, the globalization, I think this has actually been going on for a long time, but a lot of it, innovations in the aircraft industry, are joined with suppliers, and those suppliers turn out to supply both Airbus and Boeing. So you can't contain the innovation yourself. Companies left to their own devices might not innovate enough, and so there would be a reason, even if this weren't an infant industry anymore, to continue some kind of an R&D subsidy to encourage technological progress.

Especially, even that general R&D argument gets modified or reinforced for particular kinds of R&D that people are very interested in, like green technologies where we want to increase sufficiency or reduce the emissions impact. Pretty much, everyone agrees that we actually want government subsidies to do basic research on how to make airplanes have less environmental impact.

No one wants to win hands down in the subsidy dispute in the sense that the remedies that people are actually talking about are not desirable remedies.

I think this is purely the reason why you abrogated the '92 treaty now and why you are complaining about "Oh, they don't need an infant industry subsidy anymore" is that it plays well. It is a way of managing risk and making people think that, "Oh, maybe Airbus' plans aren't that good. We should have a hard look at Boeing planes and buy Boeing planes because the only reason Airbus is competitive is these subsidies. Gee, maybe the subsidies are uncertain." This is the U.S. side trying to raise uncertainty and questions in the mind of airline consumers and ultimately the public on the European side to encourage them to buy American products or buy Boeing and vice versa. The same thing happens. Both sides are just trying to raise a few questions.

The underlying situation is that subsidies aren't going to go to zero, and they probably shouldn't go to zero.

MS. BRAINARD: Hugo first.

MR. PAEMEN: I think probably the main reason is what Gene said in his first presentation. It is a new model.

Coming up with a new model as Boeing is doing now with a somewhat revolutionary new plane is a question nearly of life and death for a company. That is why I underline the risk management aspect of it, as it is for Airbus, by the way, but at this moment, perhaps a bit less.

I think both companies—and you feel it with everything that they say and how they handle the press and so on—both companies are very nervous at this moment, as well Airbus, as Boeing, exactly because

they are at a very critical moment of their existence. It is a question of life and death.

If the 787 is a failure, the civil activity of Boeing is in danger, and the same is true for Airbus. They are exactly in the same situation. So I think that, as my interpretation is concerned, is the main element.

MR. STOKES: I think there are a couple other issues to think about in terms of subsidies. One is that USTR has said, although not really put forward a proposal on this level, that they would be willing to talk about State and local subsidies in the United States, claiming all the while that Airbus also gets national and provincial local subsidies in Europe.

I am not at all certain that USTR could deliver on that if they tried. It is a federalism issue. When these kinds of subsidies came up in the OECD negotiations years ago on investment, State and localities in the United States put the kibosh on the whole negotiation. So there is the issue of those subsidies as well and what do we do about them.

There is the issue of should we both be worried about the subsidies that a China or a Japan someday again or a Brazil might be able to put into future aircraft and become greater competitors. The implications of this fight are there are only two guys in the arena, and

they are going to slug it out. We probably should all be worried about who is about to climb in the arena.

Now, we were worried about the Japanese in the '80s, and it proved to be a false worry, but I think that we shouldn't draw too much comfort from that. There is always an opportunity that someone else could try to get into the game.

The complicating factor of that is that Boeing benefits from the subsidies that Japan is going to pay to Mitsubishi Heavy to help develop the new plane, so is Boeing willing to give up those subsidies, is Boeing willing to turn to the Japanese government and say no, we will forgo those. I think this subsidy issue is highly, highly complicated, and I would come back to where Gene ended up, which is I think it is wholly unrealistic to believe that this industry will ever be unsubsidized.

We could have a rhetorical battle that starts with a goal of zero subsidies, but I think the interests of both sides, the political interests, the military interests of having some subsidies are so great, plus the externality issues that are real. That we are going to have subsidies for a long time, and it is merely a definition of how many.

MS. BRAINARD: Claude.

PARTICIPANT: Claude [inaudible].

I have a long question, but just to talk about what Mr. Gholz—his answer—your answer went immediately in terms of the case to R&D, but that doesn't really say that what the United States is only

arguing is about launch aid, and that is nothing—we can get into longer—and I will go into that. We can get into longer discussions about R&D and subsidy, but we ought to stick first to what the United States is arguing in its case.

Secondly, it seems to me that I—since this view is not represented on the panel, I would start—and I am—not just rhetorically. I would start as a policy position that if it is not going to go to zero, it ought to go as low as possible.

These are not infant industries. Mr. Gholz's excellent point was that even with the 707 and the 747, you didn't have a great spillover. So there is no way to argue that you have to have this kind of subsidy to go back the other way, and particularly, that was in the '60s and '70s.

In the '90s and certainly even in the '80s, in most sectors, including the aircraft, the spillover goes the other way. The "yes" in the '50s and the '60s, the U.S. government and I am sure the European governments, were a big part of technological government. Our economy now is much larger, and so it often is the case in aircraft as well as other technologies that the government takes things off the shelf from the commercial side.

So I agree that this is a complicated issue, but I would not agree, and Bruce and I may disagree. Bruce said we ought to not be comforted by the fact that the Japanese lost out when they tried to do this before. We probably got the Chinese.

I am not only discomfited by it, I think it is great. We have more competition. I think it is a bad idea to have just two companies.

So I see no reason to buy into as a fundamental point the idea that these companies and this sector is so strategic that you have to have government intervention, at least that is where I would start.

MS. BRAINARD: Claude is basically saying why is the aircraft industry different?, is the basic point. Subsidies are mostly disallowed by the WTO. Why is there this special agreement? What is so special about this industry?

Bruce, you go. Gene.

MR. STOKES: Gene?

MR. GHOLZ: Okay. Well, I will make a quick point about your initial thing, the U.S. cases, just about launch aid.

PARTICIPANT: In general.

MR. GHOLZ: Right. I mean—

PARTICIPANT: [Inaudible], but that is the focus.

MR. GHOLZ: It is the focus, is launch aid, because that is by far the biggest component, and it is the European case, which is almost entirely built around—actually, the way it has been reported in the past few days, they have been emphasizing the military spin-off. The way they were talking about it 4 months ago, it was almost entirely anti-NASA. Somebody may have clued the Europeans in that the current

administration doesn't like NASA aeronautics funding. So there is no reason to complain about that.

They complain about the R&D a lot, and there is some justification for R&D. The launch aid is to drive development and pull along research.

There has clearly been research and development funding as part of because they get launch aid, and in fact, one of the arguments Boeing makes—and I would have some questions about this in general, but just because it is right on your point, I will mention it—is that Airbus claims to invest a lot more in R&D than Boeing does. They gain political hay, just as the United States gains political hay, from [inaudible] they don't need an infant industry subsidy. The Europeans say Boeing hasn't invested in R&D very much. They had a major share buyback, and they gave all their extra money to the shareholders instead of investing it like a serious company would have in research. So, of course, Boeing is getting hammered, they are idiots for not investing in R&D.

Boeing just replies. They say, "The only reason you invest at a higher rate in R&D than we do is that you get launch aid." In fact, the increment of the extra amount of R&D investment that the Europeans engage in is suspiciously roughly the same level as the launch aid that they receive. So the argument is back and forth over exactly, even built

into the launch aid, that this is funding extra research that somehow otherwise wouldn't be done in the industry.

Now, I think the broader question, as Lael raised it, was why are aircraft different and why do they deserve subsidies, and part of it is just the politics of aircraft are different because they are these kind of signature, very large products that are very highly visible and they happen to be built in fairly concentrated factories where you can point to 5,000 people whose jobs are directly linked to it in a particular location. So it is a politically visible investment.

It is true that if there is a general under-investment in R&D in society, that is not limited to the aircraft industry and you could have an R&D tax credit or something like that. There would be other instruments to support R&D, not just in the aircraft industry.

I do think that it is fair to say—I will raise yet another kind of economic argument for subsidies in the aircraft industry—total demand in the aircraft industry, every aircraft sold worldwide is large, but not that large compared to the cost of developing aircraft.

So the economies of scale in the aircraft industry or the learning effects of actually as you build an aircraft costs go down. Given that economic situation, there is I think good reason to believe, at least at the current level of total global market size in aircraft, you can't support more than a couple of companies for reasons that have nothing to do with subsidies. They just have to do with the size of the market.

This industry is likely to stay as an oligopoly, and when there are industries that are oligopolies for kind of those economic structural reasons, assuming your subsidy policies don't lead to too much rent-seeking, don't lead to companies to go to sleep, there whole question is handing out the subsidies, and I will have one comment on that in a minute.

If you could hand out an ideal subsidy, you could make extra money in businesses like aircraft, and there are only a very few businesses in the world where you can make money on subsidies.

In general, the message from subsidies is you give out money and it is a waste, you are giving money to foreign consumers, but in industries like aircraft, you might be able to make money. That just means the trick is to give out money without putting your companies to sleep.

This is the difference. Sometimes you get corporate welfare and sometimes you get competitiveness, and that is the whole game in the aircraft subsidy business.

The Europeans had a long history of corporate welfare before they got Airbus, and then they kind of got the subsidy mechanism right starting in the 1980's. That would be the reason to keep doing subsidies and why aircraft is different.

MS. BRAINARD: Let me ask for another questions. Yes, over here.

MR. NEWELL: Bruce Newell, Continuing Ed at St. Mary's.

When a panelist speaks, if you don't speak right into the microphone, we have a very difficult time hearing you.

It appears to me, as you pointed out earlier, if Boeing fails now with their airplane, Boeing is out billions of dollars, and it will be 10 or 15 years before they can make another attempt at launching a new airplane.

If Airbus airplane fails at this point, it is of no risk to Airbus itself. They can certainly turn around to the governments and say, "We would like some more money," as they are currently doing for the competitor with Boeing, and this seems to me to make this plane field violently unlevel. Is that true or false?

MS. BRAINARD: Let Hugo take that one.

MR. PAEMEN: I think I wouldn't say it is false, but it is not true.

[Laughter.]

MR. PAEMEN: In this sense, the American government will never allow Boeing to go down. I can assure you. That is history, and that is too important for strategic reasons and for economic reasons. Boeing, let's say the aircraft sector, is the first export sector for the United States.

The strategic importance in terms of transportation, the rules in the United States are such that civil companies have in case of

war to put at the disposal of the government a certain number of airplanes. So the United States cannot allow, cannot afford not to have an aircraft industry, and they will not. They will not let Boeing down, as I think the European governments will not let down Airbus.

Now, that is not a good reason to subsidize, and I am against too much subsidizing, but I have to agree and I think everybody agrees, if you read the last report of the Department of Commerce, they also say that a fact is that all governments support their industry, as I said, because of the enormous investments involved.

I agree with the other speaker that the spillover is rather from the military to the civil sector. Technologically, in terms of cash, it is different. The industry will not get the money in the capital market to launch a completely new family or new revolutionary aircraft. If they don't get support in one way or another from the government, they will not be able to do so.

So all of this is linked. There will be no innovation without investment. There will be no investment without government support. That is the reality. It is history, and it is like that.

The only thing, as I said, is we should discipline and agree on common rules of the game, how all this is managed, but that you can only do when you talk to each other and you talk in terms of everything of the present situation. That was the idea of the '92 agreement. Compared to the Subsidy Code which came out of the GATT, we now

need a kind of agreement which is a king of [inaudible] for the aircraft sector compared to the very general Subsidy Code which we have in the context of the WTO.

MS. BRAINARD: [Inaudible.]

MR. EVERETT: [Inaudible] Everett with the Air Force Association.

I have a question concerning the issue of Air Force tanker replacement. There is an interesting dichotomy on Capitol Hill right now. On the one hand, Boeing has been badly wounded by the Darling [inaudible] and tanker lease scandal, and probably many members of the Senate Armed Services Committee, including Senator McCain, would likely prefer to go elsewhere for a KC-135 replacement.

On the other hand, you have other Members of Congress, including past chairman Duncan Hunter, who are very insistent on buying American and not looking to go to European contractors. I was wondering if the panelists could comment on that and maybe how that plays into the overall tension between the two sides.

MR. STOKES: That is a very good question because, as you well know, the Senate and the House will be trying to iron out the differences. The assumption is that the Senate will not want to accept Duncan Hunter's language that would restrict Airbus participation in this tanker deal.

It raises an interesting question because it seems to me, certainly it seemed to me months ago, that EADS, the parent of Airbus, should think long and hard about how important this tanker deal was to it and whether it might have been willing or should have been willing to give up more on Airbus as a quid pro quo for gaining access to the tanker deal. That hasn't worked out that way. It conceivably still could, I suppose.

My sense is, talking to my colleagues who follow this much more closely than I do, follow the appropriations process, the assumption is the Senate won't swallow the House version of that language, but we should realize based on experience that if Congress can do this once, they can do it again. They can interfere in this negotiation, in this process at another time, and it is one of the reasons why we probably have to be vigilant going forward.

I think the assumption of many of us who follow the Airbus-Boeing disputes over the years is to become very cynical about it, that these are disputes that will go on forever and they don't change very much, but there always is the wild card of Congress. I think you could envision a situation where Congress would become frustrated enough to actually pass something like the Duncan Hunter amendment, if not in this form, then in some other form.

Deals like the tanker deal only come around every so often, and it is a huge economic prize to win. I know Airbus was very anxious

to get involved in that. I assumed they would be willing to pay a price to get into that deal. They don't seem to have demonstrated a willingness to do that yet.

MR. GHOLZ: I would want to say a little something that is, I guess, on the exact slip side of that, which is Boeing's side of this deal.

I don't know how it is going to work out. I have a lousy crystal ball, but I think you might ask the same question from Boeing how badly do they want the tanker deal to save the 767 and extend 767 production, given what is going on in the subsidy controversy or more importantly with the kind of overall politics of the 787 and the overall market development of the 787, kind of their future project.

The truth of the matter is we probably don't need new tankers right away. So, in the KC-135's, 80 percent or more of our KC-135's are KC-135R's. They were rebuilt in the early 1990's. They are not old planes. They are not planes that are falling out of the sky. It is only a few KC-135Es that are left which is what they are talking about replacing.

In fact, the Air Force had no plans to replace these planes until Boeing and Senator Stevens saw an opportunity for a handout right after 9/11, and suddenly this got introduced. I think this is disastrous for Boeing.

Boeing used to be the company that focused on commercial aircraft that was very adaptive to its commercial customers, that

succeeded by not being bogged down with rent-seeking politics, looking for handouts, getting military business.

Then, in 1997, they had a strategy change. They merged with McDonnell Douglas. They got a big military business. Now they are in the game of trying to find these military subsidies that they didn't used to be in, and this has changed their strategy and complicated their life in the trade dispute. It is likely to lead to planes. If they have to design planes for the commercial market with an eye towards how does it affect their military business or how can it lead to another handout from the military or how can they spin the tanker deal, then Boeing is going to design worse planes from the perspective of the airline industry. This is a bad strategy for Boeing that they have started in the past few years, and they have created trouble for themselves.

I think the smart outcome of this problem with the tanker difficulty and the trade talks coming at the same time or the trade dispute coming at the same time, Boeing's smart play is to let the tanker contract die, just say, "We don't really need new tankers right now. In a few years, we will need new tankers, and it will be a whole different situation. We can figure out what is going on then, but for the next 2 years of the trade dispute, what is the problem? The whole tanker thing was a mistake. We're sorry."

MS. BRAINARD: Yes, right here.

PARTICIPANT: [Inaudible] Slovenia.

I have a more general question, getting back to what you said about subsidizing the industry. Would you agree that subsidizing the industry is the best possible way for that industry to exist at all?

Second, as we might be stuck with subsidizing the aircraft industry, is it that both parties really wanted this process to end up in Geneva? What was going on actually in the last 2 years? Do they really want to take it to Geneva or just one thing led to another and now we are where we are? Thank you.

MR. PAEMEN: On the first part of your question, I think subsidies are inevitable in the sector. That is our experience, and that is what all people say, and I think that is the reality.

The second part of the WTO, certainly the Europeans, I think, were not very happy with going to Geneva for the simple reason that in Geneva, the case will be handled based on the Subsidy Code. As you know, the Subsidy Code is a very general text and will approach the whole problem from, I would say, a purely legal point of view, which is normal.

In the Subsidy Code itself, it is said explicitly that multilateral talks will take place about the sector of the aircraft industry. Those talks have not taken place, and the hope at the certain moment was from the bilateral agreement between the United States and Europe would come a more multilateralization of the same type of agreement,

and that would be, as I said before, somewhat the [inaudible] for the aircraft industry.

I think that the United States, and more particularly Boeing, thinks that they have a better case before the WTO. Is that true or is that not true? I think with all the—and again, I hesitate to speculate about this because, with panels in the WTO, you will never know what is going to come out, but probably since all the somewhat direct aids which have now been given by local authorities, Washington State, et cetera, and the other case, perhaps that case is not as good as they think.

What probably is their aim is they want to negotiate, but—
[audio break].

[Side B of audiotape begins.]

MR. PAEMEN: [In progress]—of a procedure in Geneva. That is a very old trick which we have all applied many times. It would not be bad if there was a threat hanging above the head of the people on the other side of the table, and that is why the Europeans have now introduced their own case against Boeing. So they are even again. The main thing is that is not going to solve the problem, whatever WTO decision will come out.

My feeling would be if ever—if ever it goes until the end, both will be penalized. What we will have then is probably what the existing situation is between Brazil and Canada.

As you know, a certain number of years ago, there was a case between Embraer and Bombardier Canada. They went to the WTO, and both were condemned by the panel. Still today, there is no solution to that problem, and they are still giving subsidies to their own [inaudible]. So this is not going to solve the problem between Boeing and Airbus. That, you can only do by negotiations, and let's hope they will take place very soon and seriously.

MS. BRAINARD: I wanted to direct a quick question, a related question, to Bruce.

Hugo said earlier—I think I am quoting you—"it is a question of life and death." How comfortable are Americans going to be having the fate of Boeing in the hands of Pascal Lamy?

MR. STOKES: It is a question I think a lot of people are asking these days. I don't think that, practically speaking, it will be a major problem.

The case will be decided by the WTO dispute settlement mechanism over which the Director General has no direct control. He can step in, but that hasn't ever really happened.

I think by raising this issue, some Americans are focusing the spotlight on Lamy to make sure he doesn't interfere in some way.

I do think that it is more of a rhetorical tool by Americans, a little club to beat the Europeans about the head with. Knowing Lamy a bit, my sense is that he is smart enough to stay about as far away from

that issue as he can because it is so politically charged here in the United States and equally politically charged in the EU if it looked like he was bending over backwards to help the United States.

So my guess is while we may hear more about this, that practically it is not going to have any impact on the outcome of the case, except that he may use his good offices to bring the two parties together at some point to try to hammer out a deal with the practical argument being you don't want this to go to a final decision, we will both be in trouble.

More importantly, there is the problem, as Hugo mentioned, that when you have big cases like this, highly visible cases that are worth a lot of money, and if neither side can really agree with the outcome, once you have a dispute. Let's say we both lose in the WTO, but we don't ever implement. It does damage people's faith in the multilateral system which is a cost to everybody, and it is probably something that Lamy would like to avoid.

MR. GHOLZ: Can I say one quick thing?

Bruce is exactly right. It might damage the multilateral system, especially if both sides end up imposing sanctions afterwards.

The trick with the WTO is that it is supposed to encourage trade liberalization, but the penalty for violating your commitment to impose trade liberalization is more tariffs. So nobody wants that

outcome, but I think the answer to that is that people are a little bit far-sighted.

I don't know that this will happen. I am not a trade lawyer, and as Hugo said, you can't trust what WTO panels are going to do that well, but they have this great way out. It just strikes me this is the answer to this.

If the WTO dispute comes forward, there is an easy way out, which is they will say, "Look, there are these footnotes in the Subsidies Code. The Subsidies Code isn't supposed to apply to aircraft. You guys were supposed to negotiate a deal. You didn't. We are not answering this question." So the mutually assured embarrassment that Pascal Lamy talked about when he was the EU negotiator last December strikes me as actually unlikely.

The most likely outcome, despite the conventional wisdom which is that both sides will be found guilty, I think the most likely outcome is nobody is guilty. The Subsidy Code doesn't apply.

MS. BRAINARD: A question back here.

MS. CHRISTIE: Thanks. Rebecca Christie from Dow Jones Newswires.

I had two questions. The first one, Mr. Paemen, you said earlier that you thought that Boeing or Airbus would be likely to run into serious trouble if their new planes don't succeed. There is research out there by some consultants that suggest that the A-380 will never turn a

profit and was never intended to turn a profit, and I am wondering what that does to Airbus' argument.

Then my other question would be if the U.S. were to win, let's say that European countries had already given launch aid to the A-350, what remedy then could the U.S. get if the launch aid has already been given?

Thank you.

MR. PAEMEN: On the situation of the 380, I would be surprised that Airbus and the governments behind Airbus would accept to launch such an airplane without thinking that this one day would fly. First of all, it has already flown, but secondly, that it will be done in economic circumstances.

You seem to infer that they knew from the very beginning that never this plane would be economically viable. I cannot imagine that the governments would do that.

When we negotiated the agreement in 1992, I had sometimes more difficult discussions with the people of Airbus than I had with the Americans. Don't think that the European Commission is accepting the files and the arguments of Airbus just like that. They have budgets, and the European Commission is responsible for the competition policy of the European Union.

So it is not true that this idea that Airbus is European Union is European governments and money can flow without limits. There is this appraisal which has to take place before they can give the subsidies.

I can tell you at least in 1992, this was a very serious exercise. That is why it took 2 years to do it. So the idea that they start a new plane and such a big plane as quite a revolution without having the true conviction that it will be viable and it can be run in economic circumstances, I think that is an idea we have to be very careful about.

By definition, if ever it will not fly, then we are in a position where the royalty payments system comes in play, and I must say I have my doubts about the royalty payments also myself, up to a certain point.

Although this is a very honorable way of financing which is applied in other circumstances, for instance in the oil business, for instance in the book business—when you want to publish a book, it is also with royalties and according to the number of copies that are being sold—it is not a scandalous way of financing, but still, I think that one could introduce some limits to the way in which this royalty payment system works.

In principle, yes, royalty payments are a kind of guaranty. It is a kind of safety net, but as I said before, there are now only two players in the world with LCAs. It is Boeing, and it is Airbus. None of

them is going down, and it is not in the interest of Airbus that Boeing be weak or in the interest of Boeing that Airbus be weak, certainly not.

So I think governments and I hope the management of the companies will understand that and will prevent that things go too far.

MS. BRAINARD: Gene, I just wanted to get your comment on whether the A-380 is ever going to be profitable.

MR. GHOLZ: Oh, okay. Well, I also want to talk about remedy for a second, but yes. What Hugo started out saying, there are these two business models. Airbus says there is going to be hubs and lots of people are going to want to buy A-380's to concentrate international travelers at a hub, fill up a really big plane and fly to an international destination, and Boeing says we will actually want smaller planes from point to point, mid-sized cities flying internationally.

I don't know which one is right. Hugo said he doesn't know either. I think that is kind of what competition is about is that people have different business models. They try them all. Some of them make more money than others. Whether the A-380 is potentially profitable at 750 aircraft sold, Airbus says yes, and they are the only ones that know the numbers because they don't tell people what they charge for an airplane. So we can't really tell. It is possible.

Now, on the remedy question, this is I think an excellent question. If the A-350 subsidies have been given or we have stopped trying to complain about the A-380 subsidies, it is water under the

bridge, what could we do if we win? I think the bottom-line answer is there is nothing, and this is why I don't think this case is really ever going to go forward to the finish.

What the Subsidy Code has been interpreted in the past in WTO panel cases, the first remedy is to ask the company to give the subsidy back. So, if we find against the Europeans or if the other way the Europeans find against the United States, remedy number one is give the money back.

Since nobody really knows how the accounts work, I don't know how we would know if they gave it back. I can't imagine any company writing a check for \$5 billion to give the money back from the A-380. It just doesn't seem plausible.

So then what happens is you get these authorized sanctions, and it might be if you are really cynical about this, that what the United States really wants is authorization to protect some other industries. The last time we protected the steel industry, we lost the WTO tiff or we got in trouble in a WTO tiff. Right? So we would like an excuse to protect the industries that we want to protect. How will we do that? We will win a WTO case that we can win on aircraft. It will authorize us to impose some number of billions of dollars of sanctions on other countries where we get to choose what sector.

Nothing says if you win a case in aircraft, you have to put the tariffs on aircraft. So we could put our penalty tariffs on steel or

textiles or whatever it is that we are tired of importing from Europe for domestic political reasons, and maybe that is the remedy we want. I think that is a cynical story.

The story as a political economy analyst is there is no remedy. We don't want to win. We want free trade in all those other sectors. This probably just won't go forward.

MS. BRAINARD: A question back in the middle of the cabin. Actually, there was a gentleman behind you, and then we will bring it forward.

PARTICIPANT: In the economy section.

PARTICIPANT: I will attempt a question from the economy class. I am Nicholas [inaudible], a visiting Fellow here at Brookings.

We have focused mainly on Boeing and Airbus, and, of course, rightly so. I think maybe it would be nice to hear what you think about the contractors to those very two companies because it seems to me each time a Boeing is sold, lots of European contractors benefit from this and possibly the same thing from Airbus. This also seems to me that the contractors often work for both companies.

So, to an extent, selling a Boeing is good for Europe. Could you maybe integrate this a little bit and make some comments about this?

MR. STOKES: Well, I won't try to integrate it economically. I think the numbers kind of speak for themselves. Both companies claim huge proportions of their aircraft are actually from the

geographic area of their competitor, and they do this for economic reasons. They want to be able to sell aircraft in that other region.

One of the reasons Boeing for years shied away from filing a case against Airbus is they were afraid that their sales in Europe would dry up. So they are no dummies. They avoided bringing a case.

They don't seem to fear that now, and one of the interesting questions is why. Are they so desperate that they had to file this case? Did they just get combative for some reason?

I think politically, it is a more interesting question. My sense is Boeing has done a much better job with the U.S. Congress in terms of being able to demonstrate to a Member of Congress that X-number of jobs in his or her district depend on Boeing selling airplanes.

Airbus obviously doesn't have as large a net of suppliers in the U.S., but has a fairly significant one. My sense is that they have not been as good as being able to go into a Member of Congress' office and say there are 300 jobs in your district that could get lost if we don't get the tanker deal, if we lose this WTO case, but my guess is you will see Airbus doing more and more of that because ultimately this is about politics.

The model that Boeing elaborated over time was to spread out its suppliers over a wide geographic region for political reasons, and Airbus is doing the same thing, and I think you will see more of that.

MR. GHOLZ: What Bruce said is basically true. I am not sure that Airbus has had much reason to politically explain in the past that a lot of their parts come from the United States, but they have clearly explained that over and over to the airlines in the United States.

So one of the conscious strategies from the very beginning on the A-300, the first Airbus airplane, was to source more than half the parts from American subcontractors. This has always happened for Airbus, and this isn't just talking about the engines. It is talking about landing gear and avionics and lots of different parts of it because they were trying to make American Airlines, actually American Airlines the company, but also broader airlines in the United States feel comfortable buying the Airbus product.

In fact, a lot of the Airbus A-300 design was heavily influenced by the chief engineer of American Airlines at that time because they were trying to sell into the United States. American Airlines then decided not to buy the plane anyway, but then Airbus was stuck with these American suppliers which probably actually made pretty good parts and had the benefits of if there were some kind of technological or financial benefit of working with the American Defense Department, Airbus got it too, not Boeing and not just McDonnell Douglas. So it didn't cause any "material injury" is the magic word in the WTO. It didn't affect the relative competitiveness of either side because they have always had these integrated supplier networks of

Europeans sourcing products to America and actually to a lesser extent, but still a significant extent, America sourcing in Europe.

MS. BRAINARD: We had a question in Seat 9F, right at the economic plus, right there.

MS. MARTIN: Abbey Martin, Confederation of British Industry.

I guess given the premise that this will be indeed worked-out negotiations and to follow up to your comment that Lamy should stay out of it, given the key players, Mendelson, Zoelick, some of the history between those two, Lamy, Zoelick, Portman, what do you think given some insight into who will be around the table and who will be taking the lead? If you indeed say that Lamy should stay out, even though it might have a better personal relationship with Zoelick and the recent fallout between Zoelick and Mendelson, that type of scenario?

MR. PAEMEN: That is the hypothesis that it would continue in the WTO. If it continues in the WTO, it will be decided. It will be first in the DSB on the 13th of June, which by the way is the day of the opening of the Paris Air Show, and that is because they didn't want to do it on the 20th of June because that was the day of the Summit between the EU and the U.S. So there were two critical dates between which they had to make a choice. They finally decided to do it on the 13th of June, but as you know when you ask a panel in the WTO, nearly

automatically the other party says no. You can say no once, but the next meeting, the panel will be established.

That is where a possible role for Lamy could come in. If the United States and Europe can't agree on the composition of the panel—the panel is three experts who, by definition, will not be American nor European—if they can't agree on the composition of the panel, then at a certain stage, the Director General can come in and decide on the composition of the panel. So there is a potential role for Lamy.

Again, I don't think that these two cases will go until the end. There will be negotiations in the meantime, I hope, but if ever it goes until the end, you have 12 months which can be extended by 6 more months, so that that is 18 months, and by the way, in the meantime, people can largely subsidize because it is going to take 18 months. Then, even if you don't agree with the result of the panel, the decision of the panel, you can appeal, and the appeal, again, can bring you 3 months, but that can also be extended.

So you are in for an exercise that is going to take 2, 3 years, and what is happening in the meantime, in the meantime business has to go on. The 787 will go on. The 350 will go on. The 380 will go on. So WTO is really not the solution in this case.

MR. GHOLZ: Hugo alludes to something, and I wanted to make sure I made this point before we ended. It seems to me we have a

longer-term structural problem in the system that this only highlights, and it is an opportunity to try to address it.

We attempted to settle this issue through multilateral negotiations. As Hugo said, they really never got off the ground. We have failed similarly on steel in multilateral negotiations. The assumption is that the big boys should get together around a table and sort out their differences, and they have demonstrated repeatedly the difficulty of doing that.

So what is the default position? You go back to a juridical approach where hopefully you will be forced to settle.

We have now expressed real concern about whether anybody would really be forced to settle if the WTO rules.

We need a third alternative. We need a Plan C because this subsidy debate on Airbus-Boeing will continue. By the end of this decade, people in the industry point out to me that both Boeing and Airbus will need to begin to replace some of their workhorse airplanes. Those are going to be very expensive. It may be difficult to raise the money in capital markets. It may be difficult to raise the money from taxpayers, but there is a challenge that is looming at the end of the decade where this problem could return in spades, and we don't have a satisfactory approach to disciplining ourselves, either juridically or politically.

I don't have an answer to that, but it seems to me it is the challenge the system faces that we can't continue to delay addressing.

MS. BRAINARD: A question from way in the back.

MR. MAGNUS: John Magnus with Trade Winds.

I think I heard all three of the panelists say that some level of subsidization in the sector is inevitable. I just wanted to ask you to talk on that thread a little bit harder.

Is it inevitable that there will be aerospace-specific or aircraft-specific subsidy schemes in place, or is it possible that whatever level of subsidization has to exist could be coming in the form of horizontal programs perhaps defined on the basis of technology in which aircraft producers and lots of other folks participate? I think that gets perhaps to the heart of the U.S. claim that there is something really different about launch aid as compared with the Federal measures that are being challenged in the case against the United States.

MR. GHOLZ: I think you are right in a sense to say a lot of the reasons why we might want, from an economic perspective, to subsidize at all are linked to technology in general. You could have the horizontal program kind of language of these trade disputes that says any technology company can apply for this kind of subsidy, and that would make it nonspecific, which is a magic word for getting you out of the WTO Subsidy Code.

Since I think the aircraft industry is probably already out the WTO Subsidy Code, I am not sure that we are going to see a need to do that, but there are lots of ways. These political interests are clever. Smart people work for them, and they look for smart ways. It is like a balloon. If you squeeze one part of it, they will find a different way to expand. There is a real political and economical interest in having these subsidies. So however you rename it, in a sense what we are looking for is the most efficient way and the most effective way to give out these subsidies. If a horizontal way works out better than an aircraft-specific way, we would be better off.

I am skeptical that that is actually true. I think one of the general technology programs don't have a great history because the people handing out the money are supposed to be generalist experts in all technology. So they get confused about where they should give the money. Everyone is offering to sell them something, the next new great thing, and it all sounds good. So they have trouble telling where the right place to invest is.

Whereas, if you have sector-specific kinds of arrangements, you can get better advice. You can have the companies more engaged. You probably have a better potential for an effective subsidy that will actually develop a useful product instead of a white elephant or instead of a corporate welfare kind of situation, but the bottom line is that

whether it is politics or economics, someone will find a way to give the money.

MR. STOKES: And also to warn you, I too share the intellectual attraction of a generalized subsidy, but the reality is we would argue, the U.S. government at least argues, that the way we fixed the FISC is generalized. The Europeans say, in fact, it is a disguised subsidy of Boeing, among other people, it is very targeted. So it is all in the eyes of the beholder.

MS. BRAINARD: Unless there are any other questions that I have missed—oh, yes. I have missed the final question in the back.

PARTICIPANT: Jean [inaudible]. I am part to the dispute as a member of the French Embassy. So I won't comment on that.

I just want to give a fact and remind Hugo of a fact. The reason why there is no multilateral agreement on subsidies, we were one foot close to having an agreement. In the last night before the end of the Uruguay Round, on the basis of the '92 bilateral agreement, i.e., launch aid versus so-called "indirect support," the reason we did not get an agreement is that the people at GE and Pratt & Whitney heard about that, looked at the figure, and said, "You guys are kidding. We get much more indirect support. We will never agree to a multilateral agreement on the basis of the 1992 agreement."

It is nice to talk about aircraft manufacturers, but don't forget that aircraft need engines, and the support that is given to the engine industry is staggering, indeed.

MS. BRAINARD: Let me ask the final question. I think I have a sense already of where your answers are, but I want you to make a clear, concise prediction. Win, lose, draw, and when are we going to know?

Gene first.

MR. GHOLZ: Well, I don't know win, lose, draw, but I think of the four possible outcomes, no one is sanctioned, both are sanctioned, only Europe and only U.S. The most likely is no one. It is the opposite of the conventional wisdom which is both, and if I had to pick one, I think it is highly unlikely that you will get an outcome with one, just because it would be politically very difficult for the WTO, but I do think if you had to choose only one, Europe would get sanctioned, not the U.S. But the most likely outcome is nobody.

Timing? I don't know. As soon as people figure out, it is the best idea.

MS. BRAINARD: Hugh, agree?

MR. PAEMEN: Well, again, I think that the reasonable outcome would be negotiations and not bringing the WTO cases until the end.

If they have to be brought until the end, I think both sides will for certain aspects of their subsidization policy will be condemned, will be found guilty, but it will be perhaps not 100-percent condemnation. So, for certain aspects they will, for others they will not, as very often panels do, but that, again, is not going to solve the problem.

MS. BRAINARD: Bruce.

MR. STOKES: I will go out on a limb and say that the case will be withdrawn. Both cases will be withdrawn, and there will be a settlement at the end of the Doha Round.

MS. BRAINARD: Thank you all very much.

[Applause.]

[End of briefing.]

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