

dti

the department for Enterprise

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

C D Powell Esq
10 Downing Street
London SW1

Direct line 212 6708
Our ref
Your ref
Date 2 February 1988

Department of
Trade and Industry

Ashdown House
123 Victoria Street
London SW1E 6RB

Switchboard
01-212 7676

Telex 8813148 DIHQ G
Fax 01-828 3258

BAC for the
trader of
land and.

Rec'd
like 4/2

PK
You may like
to see this,
which has come
on a personal basis

Dear Charles,

CD 3/2.

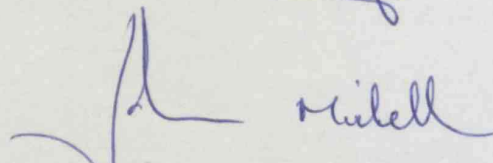
AIRBUS

FIG WITH COP

Further to my letters of last November/December and our brief conversation the other morning, you may like to see my report (attached) on the most recent meeting on Airbus between US and EC officials. The position is difficult, and appears likely to come to a head in mid-March. However, we have not yet given up hope of achieving a negotiated settlement.

X | On the related matter of BAe's financial position, the company is considering taking a very substantial provision (up to £250m) in their 1987 accounts, to be published in March 1988, against potential losses on Airbus due to the fall of the dollar. BAe have requested DTI Ministers to consider further financial support. Our Ministers here have made clear they would be extremely reluctant to countenance this, and that they would not even consider the matter further in the absence of a detailed case from BAe. This is not yet forthcoming. We expect the French and German Governments to agree to make additional financial support available to their Airbus companies at some time during this year.

Yours sincerely,



M J MICHELL

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

CONFIDENTIAL



the department for Enterprise

To: PS/CHANCELLOR OF THE DUCHY

cc PS/Secretary of State
PS/Mr Atkins
Sir Brian Hayes

From: M J MICHELL
US Air
Room 619
Ashdown House
212 6708

Mr Roberts
Mr Williams
Mr Hutton EEP
Mr Cooke OT2
Mr Bowder Air 2
Mr Soane EEP
Mrs Coe Air 2
Mr Braithwaite FCO
Mr Beetham FCO
Mr Hunt Washington

1 February 1988

AIRBUS EC/US TALKS

The submission is a situation report on the EC/US talks on Airbus. It is now up to the EC to decide its next move. No immediate decisions are requested, but a Ministerial meeting with European colleagues may be desirable earlier than the currently planned date of 1 March.

Present Situation

2 There was after all a further official level meeting with the US last week, the Commission report to Ministers at Lyon that the meeting had been cancelled proving to be a mistake. The US tabled fresh proposals for an agreement. These did not contain any proposals for a pricing agreement, and the Americans now say they do not expect to make any such proposals. The US proposals therefore concentrated entirely on disciplines to be applied to Government supports.

3 While the US proposals still represent a hard line, unacceptable as it stands on key points, in our view they also contain quite significant movements by the US from their earlier position. If this were a UK/US negotiation, I would see a reasonable prospect of reaching a compromise agreement without too much difficulty.

4 Our partners, however, do not see the situation in the same light. The French, unfortunately represented on this occasion only by the Department of Trade, were under direct instruction from M. Noir (apparently for electoral reasons) to decline to discuss the possibility of internationally agreed disciplines on supports going beyond the GATT aircraft agreement, on the grounds that this was a matter of national sovereignty.

5 The Germans did not go this far but consider the US proposals so far removed from anything they could accept that they see little possibility of a negotiated settlement.

CONFIDENTIAL

6 As anticipated, the Commission found themselves hindered rather than helped by the document "agreed" by Ministers in Lyon. Moreover they handled the meeting rather badly, adopting an unnecessarily aggressive tone when the right tactic appeared to be to play for time politely.

7 At one point it seemed quite likely the US would break off the talks immediately. They did not, but made clear they currently regard the Ministerial EC/US meeting on 18 March as a firm negotiating deadline.

Next Moves

8 Partly as a result of the Commission's indifferent handling, the ball is now in the European court to reply to the US proposals.

9 The likely reaction of the American side must be an important factor in determining our own strategy. The threats of imminent trade action, characteristic of the latter part of 1987, have receded, and it seems unlikely any action would be initiated before the EC/US Ministerial meeting scheduled for 18 March. Whether or not our attempts at applying direct pressure have had any effect, Boeing seem now noticeably less belligerent, and McDonnell Douglas seem prepared to bide their time at least until mid-March. There seem to be a number of reasons for this:

- i The fall of the dollar
- ii McDonnell Douglas confidence in the UDF engine and the MD-92, which is now being marketed at \$29m (1987 prices) against the A.320's \$32m.
- iii Boeing fear of European retaliation
- iv The collaboration discussions with MDD. On this, my French colleague M. Lagorce has been in Longbeach this weekend pursuing the same line as Mr Clarke on his recent visit.

On the US Government side, the USTR (Mr Yeutter) is believed genuinely to want a "good" agreement to mark his closing months in office. However, if this proves unattainable, it seems quite likely that the Administration would want to be seen to be taking a "tough line with the Europeans" for electoral reasons and to deflect pressure for new protectionist trade legislation. While therefore it is possible the US Government would not countenance a trade action against Airbus (and US officials have openly admitted they might have difficulty proving material damage to US companies) it would be unwise to rely wholly on this beyond mid-March, if the negotiations have made no real headway by then.

10 The Germans (at official level) consider the right course is to continue to negotiate with the US, but without any specific objective of concluding an agreement by a certain date. Indeed,

in the knowledge that they will almost certainly be giving further support to Messerschmitt in the latter part of this year, the Germans would prefer not to conclude an agreement. The Germans consider it quite likely the US Administration will support, or even initiate, a trade action against Airbus if there is no agreement by mid-March, but see this only as a further step in the negotiations, not as a disaster.

11 For the Air Division (UK), I am not so sanguine as this. I am inclined to agree with the German analysis that the electoral pressures on the US Administration to act against Airbus could prove irresistible. But I would still consider that the initiation of an action against Airbus is something to be avoided if possible, if only because in the end it will change nothing: in practice the action will have to result in a negotiated settlement, but once litigation is started the EC seems likely to be in a weaker negotiating position than before. Therefore I would conclude that the right course is to continue negotiating in good faith with the object of reaching an agreement, though I would not think we for our part need necessarily regard 18 March as a final deadline, nor be too dismayed if the negotiations are unsuccessful, provided we do not ourselves incur the odium of breaking them off.

12 Thus both the Germans and ourselves would be in favour of continuing negotiations with the US, although with a differing approach to the outcome. In comparison with this, the current French attitude is an inconvenience. If there is anything that will create irresistible political pressure in the US for action against Airbus, it is the French Department of Trade's current stance. This stance is not supported by the French Department of Transport. It is probably worth considering whether there is anything to be done to change the French position (see below).

13 The Commission are no doubt in a difficult situation, but their weakness cannot wholly be explained by this. They appear to have different views between themselves on what their proper role is, and to feel inhibited about taking a firm lead.

Action

14 The immediate issues are:

- i What to do about the French
- ii How to construct a new European position, in response to the latest US proposals, which will give the negotiations a chance to continue.

The French position is developing very much along the lines predicted last year. M. Noir is currently in the lead, and is adopting a high risk strategy apparently for electoral reasons. Others in France will not be slow to discredit him if they see an opportunity. It is a question of a battle for M. Chirac's ear (rather than M. Mitterand's, it appears) and M. Noir currently

has it. It may be worth our indicating that HMG does not consider M. Noir's position helpful. This can be done through the FCO network, through the French Department of Transport (which could possibly be significantly strengthened by the overt support of ourselves, drawing on the credit established during the A.330/340 launch decision period in 1986/7), direct through the Department of Trade itself, or through 10 Downing Street direct to M. Chirac. At this stage I would think a combination of the FCO and Department of Transport routes would be appropriate.

15 As to establishing a new European position, I believe there may be certain points that could be combined into a respectable counter-offer at this stage to the US proposals without (yet) compromising the key points for the French and Germans. But to construct such a position would certainly require a Ministerial directive in those countries, and would require substantive movement from their current positions (and quite possibly from our own too).

Role of the UK

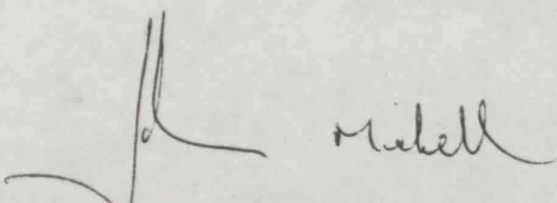
16 If a new European position is to be established, we would probably need to be the driving force behind it, as we were behind the current EC position established in November 1987. We have so far resisted certain appeals from the US, and from some in Germany and the Commission, to assume a more overt mediating role. To a limited extent we are already beginning to do this unofficially, but I do not think we should yet do it officially. We may need to do so at a later stage.

Procedure

17 My French and German colleagues and I have agreed to meet this week to review the position, and thereafter to brief Ministers. I intend to suggest to my colleagues some ways in which we might respond to the US. If possible it seems desirable to bring forward the meeting already planned for 1 March.

18 Commissioner de Clercq, I see, is proposing another dinner meeting for 10 March. If the Commission are to play an effective part, this is really much too late in relation to a Ministerial meeting with the US on 18 March or to the next, important, official meeting. Moreover, I am not sure meeting over dinner on such substantial subjects is satisfactory, but that is a personal view! We shall probably find that Commission officials themselves are proposing an earlier meeting.

19 I regret these continual changes of arrangements, which are fairly typical of collaborative aircraft projects but no doubt very inconvenient to you. I will report further later in the week.



M J MICHELL

AGROSPACE : Airbus PT3