

CONFIDENTIAL

Prime Minister

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Further evidence of
French & German
attachment to
subsidies.
C88/8/2.

EC/US DISPUTE OVER AIRBUS

Airbus Ministers met in Madrid on 30 January to discuss how the dispute with the US over Government supports for Airbus programmes could be taken forward. We are due to meet again shortly and I seek colleagues assistance in making progress in resolving this dispute.

2. The dispute has extended over several years. The US civil aircraft manufacturers are concerned by Airbus penetration of their markets. They and the US administration argue that Airbus has received an unfair advantage from the direct financial support given by Airbus Governments. They want those supports to be reduced and preferably eliminated altogether. The French and German Governments argue that such direct supports are necessary to counter the advantage the two main US manufacturers have derived from indirect support from the huge US military and NASA spending on aerospace. Without European Government support, consumers - airlines and passengers - would have been faced with

a US monopoly (and less technologically advanced aircraft). The Commission has for these reasons turned a blind eye to these very large state aids. We have launch aided the last two Airbus programmes (the A320 and A330/340) but on the basis that we have a reasonable expectation of getting our money back plus a real rate of return.

3. Officials' discussion with the US have been protracted and not productive. Detailed texts have been considered but the US have aimed high in seeking to replace European direct supports by loans on commercial terms and have sought a detailed legalistic agreement that could be enforced. The French and German Governments have been extremely reluctant to follow this path because they do not accept that European practice is "unfair" and wish to keep their options open for future Airbus programmes. For our part, I very much doubt whether we would want to offer more launch aid in the future given our policy to move away from near-market support. Moreover, we should like to capitalise on the US concern to try to bring about some discipline in Europe on state aids to companies involved in civil aircraft. BAe for example are disadvantaged by supports to smaller civil aircraft in France and Italy and our equipment companies like Dowty are also up against subsidised competitors. The European playing field is far from level.

4. The talks with the US have been suspended since July 1989 while the US responded to the German arrangements for privatising MBB. An essential element of the sale to Daimler Benz has been an exchange rate guarantee scheme to protect Daimler-Benz against exchange rate losses on Airbus caused by a weak \$. With some justification, the US regard this as illegal under the GATT Subsidies Code, although they recognise as we do that it was a necessary step to secure the more important objective of privatisation. The US fear however, that such schemes will spread if not challenged and are seeking GATT conciliation of their complaint.

5. Conciliation is unlikely to be productive and the US may move quickly to formal dispute settlement. This would involve a GATT panel which if, as seems likely, it were to rule in their favour might recommend some modification to the German scheme. The Germans would almost certainly resist any change and the US could then use their domestic trade legislation to impose duties or other trade restrictive measures on Airbus imports in to the US. This could have a severe effect on sales to US airlines. If combined with a downturn in the market, there could be a substantial financial impact on Airbus, the partners and ultimately on Governments who have provided support, possibly to the extent of having to provide further financial support. There are of course possibilities for retaliatory action which the US

would have to take into account eg Lufthansa, state-owned, are the largest European purchaser of Boeing. As a result, a trade war is probably unlikely. Nevertheless, the US action could deter US airlines from continuing with their planned orders and this would have a serious impact on Airbus Industrie and the partners. The senior management of AI certainly take this view.

6. To avoid this, I have pressed my French and German colleagues to agree that the wider Airbus dialogue with the US should be reopened in a positive and constructive way; and that we should offer a declaration that the German exchange rate scheme specifically for Daimler-Benz is a "one-off" not to be repeated. US officials agree, informally, that such moves, if of substance, could persuade them to suspend further GATT action against the Germans (although I have to say Mrs Hills, the US Trade Representative, would not give me this assurance when I saw her in Washington recently). If they are not persuaded, then they would pursue the Germans in GATT. The Commission who are leading for the European side - and in this case it is in the UK's interest that they do so - have indicated to the US that such a move would prevent further talks on Airbus.

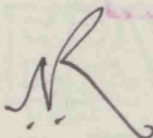
7. Thus, we have a small and perhaps last window of opportunity to secure a solution to this long running dispute. At the Madrid meeting we discussed a unilateral European "Code

of Conduct" which would set out how the Airbus Governments would over time reduce their supports to Airbus, and also a "non-proliferation" declaration on exchange rate guarantees. The French Trade Minister was unsympathetic to both; the German Aerospace Minister somewhat more sympathetic. Neither seem to share my (and the Commission's) apprehension of the outcome should we not secure some agreement with the US. I am favourably inclined to a unilateral Code, because it gives us flexibility and does not require detailed negotiation with the US. Equally importantly, it begins the process of bringing the provisions of the Treaty of Rome to bear on Airbus matters if a willingness of Airbus Governments to reduce State Aids encourages the Commission to take a more active role. The French object to a Code because they see it as bringing the Commission into an area they have hitherto ignored and because they see a Code as a legal instrument that would need agreement of the Council. I regard a Code as a self-denying ordinance which would not necessarily involve the Council.

8. The responsible Commissioner, Mr Andriessen, is pressing the French and German Ministers to be more accommodating and we are all to meet in Paris shortly to discuss a revised draft text to put to the US authorities. If we are to succeed in producing an agreed text, I shall have to press my opposite numbers very hard and it would be great help to me if colleagues would make use of

any opportunities that they might have to press their French and German opposite numbers as appropriate to bring this apparently endless dispute with the US to a satisfactory close. Of course, the US might not accept what we offer but if we can put a reasonable proposition on the table it will not be for want of our trying. Meanwhile, both we and the Commission are urging the US to stay their hands on a further approach to GATT until the Ministerial discussion has taken place.

9. I am copying this minute to members of OD(E) and to Sir Robin Butler.



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7 February 1990

DEPARTMENT OF TRADE AND INDUSTRY

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