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10 DOWNING STREET

LONDON SW1A 2AA

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C: Foreign/
Airbus

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From the Private Secretary

29 July 1990

EC/US AIRBUS DISPUTE

The Prime Minister was grateful for the Trade and Industry Secretary's minute of 22 July bringing her up to date on developments in the discussions between the EC and the US on Government support for civil aircraft. She is naturally concerned by the consequences of escalation of this dispute, and hopes very much that some compromise can be found at the last moment.

CHARLES POWELL

Martin Stanley Esq
Department of Trade and Industry

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Ric Riccio

We are into

advanced brinkmanship.I should think a solution
will be found at the

PRIME MINISTER

EC/US AIRBUS DISPUTE

I am writing to inform you about the latest, critical
developments in the discussions between the EC and US on
government support for civil aircraft. very late minute

You may recall that 31 July was the date settled on by the US and
EC as the target date for reaching an agreement. In his report
of 18 June on the dispute. Nicholas explained that while there
had been some progress during the talks up until then, there was
still a considerable gap between the two sides in particular on
the amount of support that should be allowed for development
costs.

Subsequent talks have failed to bridge that gap: the US have
said they are looking for a reduction in the percentage of
support offered to 30% of total development costs and that they
would want a substantial portion of the loan to be repayable on a
fixed basis (rather than purely on a royalty basis as is current
European practice). The EC offered to reduce support to 50%,
repayable entirely on a royalty basis, or to 55% of which 10%
would be repaid on a fixed basis and 45% as royalties, with a
possible further reduction if progress is made in getting the
agreement more widely adopted by other GATT signatories. The
Americans, however, rejected this offer and said that without
further concessions from the European side by 31 July on the

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amount of development support offered they will regard the talks as having broken down and will immediately file a (long-threatened) complaint to GATT against the exchange rate guarantee scheme operated by the German Government for its aerospace company MBB.

The European Commission has proposed that we should offer the US a further reduction in the maximum limit of development support. I have given my support to this initiative which I believe is the best way of avoiding a potentially very damaging trade dispute. Although British Aerospace will be unhappy with an reduction in total permissible support below 50%, I believe that a stricter limit is in our interests as it contributes to our long-term objective of reducing excessive subsidies given by other Governments to companies in the aerospace sector.

I understand that my German and Spanish counterparts are likely to accept the Commission's proposal and that the French may be prepared to show some flexibility, in spite of the fact that until now they have been reluctant to make an offer to restrict support to below 50%.

If we do fail to reach an agreement by the end of the month, the Americans will almost certainly take action in GATT against the German exchange rate guarantee scheme (a special scheme formulated as part of the privatisation package for MBB's sale to Daimler-Benz). More worrying would be either the initiation of action under US trade laws (Section 301) which could lead to the imposition of duties or other import restrictions affecting Airbus countries (not necessarily restricted to the aircraft

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sector) or the filing (probably by the US industry) of a countervailing case against Airbus, which if successful could lead to the imposition of duties on Airbus imports. McDonnell Douglas who only recently announced major job losses may well be inclined to initiate action against Airbus.

Airbus sales to the US would be very vulnerable to the imposition of duties since they do not have a significant price advantage over US planes. UK industry stands to lose a considerable amount if Airbus could no longer sell to the US (the UK's share of outstanding orders of European planes to the US is worth some \$3.2bn).

The European options for a response to any trade action by the US are limited. Responding with action against the import of US aircraft to Europe could be potentially nearly as damaging to our industry as the consequences of US action, because of the large element of UK content in many US planes (in particular Rolls Royce engines). If the US took unilateral action, which we regard as illegal under the GATT, Europe could retaliate with the imposition of duties on whatever product was considered most likely to be damaging to the US - but we would then be in an all-out trade war.

Any trade conflict between the EC and US on Airbus would undoubtedly have implications for the wider discussions within the Uruguay Round. In particular, the US are likely to seek a tightening up of the existing Subsidies Code that would rule out

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development support for aircraft. I strongly hope we shall be able to avoid trade conflict. I shall of course keep you in touch with developments.

A handwritten signature in blue ink, appearing to be 'P L'.

P L

27 July 1990

DEPARTMENT OF TRADE AND INDUSTRY

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The Rt. Hon. Nicholas Ridley MP
Secretary of State for Trade and Industry

The Rt Hon David Hunt MBE MP
Secretary of State for Wales
Welsh Office
Gwydyr House
Whitehall
London SW1A 2ER

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Enquiries
071-215 5000

Telex 8811074/5 DTHQ G
Fax 071-222 2629

Direct line
Our ref
Your ref
Date

071 215 5622
PB5AFT

9 July 1990

Dear David

Thank you for your letter of 26 June about Dowty Rotol.

I share your regret that the company has decided to set up its new plant in Canada rather than the UK and I can understand that you must be particularly disappointed as the preferred UK site was in South Wales. As you say in your letter, the company had good strategic reasons to go to North America, such as protection against dollar fluctuations and proximity to the North American aircraft manufacturers, such as Boeing. However, there is no escaping the fact that the company was also influenced by the generosity of the Canadian package and a perceived lack of support for aerospace developments and I would like to take this opportunity to bring them to the attention of colleagues.

First the Canadian investment package, as I understand it, is very generous and sets an unfortunate precedent. I believe that you are quite right to say that the UK should not try to match it. Companies with internationally mobile projects become very skilled at playing governments off against each other and the net losers are the governments. Instead, it would be better if we could seek agreements with other countries to limit this type of support, but unfortunately at the present, this is not covered by the GATT codes. This type of action by the Canadians is especially galling at a time when we are trying to reduce state aids for industry in the EC and are also currently engaged in talks with the US (in conjunction with our Airbus partners and the European Commission) on reaching an agreement that would restrict sectoral specific support for development of large civil



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