The Big Blowout: Why the Airbus-Boeing case could wreck the WTO, and how to stop it

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April 4 issue - On March 19, U.S. Deputy Secretary of State Robert Zoellick and European Union Trade Commissioner Peter Mandelson had a heated one-hour telephone call. The subject: the trade dispute pitting Boeing against Airbus. Afterward both sides accused one another of bad faith. Within days tempers had cooled, but it was still clear that this is becoming the nastiest transatlantic trade dispute in years, one that could jar not only the global trading system, but political cooperation among the major industrial nations as well.

The spat has outgrown the World Trade Organization, which did not yet exist when the United States and EU first addressed the charges of unfair trade practices in the aerospace industry back in 1992. Since then, both Airbus and Boeing have outsourced work to Asia and Latin America, transforming themselves into international, rather than continental, manufacturing networks. This case is now global, rather than transatlantic, raising the stakes. When Airbus surpassed Boeing in global sales and market share two years ago, it became Europe's most important "national champion," and has been cited as a model for other state-sponsored champions from biotech to energy. Though American leaders don't speak of government-backed "champions," they are no less firmly behind Boeing. That's why this dispute requires an extraordinary solution, one outside the normal bounds of the WTO.

Before I outline my proposal, let me lay out the forces that make extraordinary measures necessary. The 1992 agreement was deeply flawed; rather than eliminating subsidies, it attempted to define which subsidies are permissible, and the debate over what this means has been escalating ever since. According to U.S. estimates (also hotly disputed), Airbus has used $15 billion in subsidies to build its global aircraft market share from 30 percent to near 60 percent. Washington's case is that Airbus has long since outgrown an infant industry's need for aid.

Brussels counters that Boeing is subsidized, too, only in different ways, by government defense contracts and research grants, as well as $3 billion in tax breaks from Washington state. The EU also identifies subsidies of more than $1 billion received by Boeing's Japanese subcontractors—Mitsubishi, Kawasaki and Fuji Heavy Industries. (Yet Airbus is moving the same way; it recently cut a deal with state-owned China Aviation Industry Corp.)

In the heat of the presidential campaign last October, the Bush administration filed a WTO suit calling for an end to Airbus subsidies. The EU countersued, saying Boeing, too, had received illegal government support. In January, on the eve of George W. Bush's trip to Europe, where he hoped to mend the transatlantic Iraq rift, the two sides agreed to try to settle the case amicably, outside the WTO, by April 11. The period of calm was brief. The next day Airbus CEO Noel Forgeard trumpeted his plan to apply for subsidies for new planes. Within a week, French President Jacques Chirac, unveiling a new Airbus plane in Toulouse, hailed the giant's success as a model "in other fields, in energy, in transport and medicine," implying that the subsidized company represented the future of European industrial policy.

The dynamics of the Airbus-Boeing competition make an "out of court" settlement unlikely. High-tech manufacturing teaches critical skills, provides jobs and produces valuable research and profitable exports, making both Washington and Brussels reluctant to weaken support for the aerospace giants. Boeing is already in precarious shape, racked by scandals related to ethics and hiring Pentagon insiders. Worse, Airbus has announced its intention to make refueling tankers and passenger aircraft in the United States, challenging Boeing on its home turf. Fact is, Boeing's survival may depend on the elimination of subsidies to Airbus—and perhaps even more help from Uncle Sam.

For its part, Europe is obsessed with building a culture of greater innovation, and to many European leaders, Airbus is exhibit A of how to fashion a successful industrial policy to do so. In fact, given the glacial pace of reform in the EU, it may be the only major exhibit. And while Airbus is faring well now, EU officials are also concerned that a strengthening euro will undercut overseas sales. It's no wonder that they have tied cuts in their subsidies to reductions in U.S. subsidies—a quid pro quo that the EU probably believes Washington cannot deliver. The two companies are also competing for critical markets in Asia, particularly China and Japan.

No question, this conflict is the fiercest, biggest and most politically charged commercial dispute in the world. And so it is no surprise that Zoellick and Mandelson came to verbal blows. Of course, there is still a slight chance that a bilateral agreement will be reached, if not by April 11 then in the following weeks. But it is also possible that those talks will break down and the WTO will be forced to take the case.

Alas, the trade organization is not equipped to handle so large a dispute between its leading powers. Odds are the WTO would find both parties guilty of illegal subsidies and would levy sanctions on both. Washington and Brussels would likely ignore the verdict, badly damaging the credibility of the WTO. That would disrupt the Doha Round of global trade talks, and could undermine U.S.-EU efforts to work together on issues from Iraq to foreign aid.

There is a way out. The two parties could agree to binding arbitration by a distinguished third party from Asia or Latin America, and a new framework for the talks. First, the 1992 bilateral agreement would become a global one, including Japan and China. Outsourcing has become big business; the new accord should recognize that reality. Second, the goal should be the gradual elimination of all non-defense subsidies, because Boeing and Airbus no longer need taxpayer support. Third, the new deal should contain provisions for calculating the size and impact of subsidies, using independent audits and international accounting standards. That would bring the agreement in line with post-Enron principles of good governance.

Will any of this happen? Probably not, for the parties are dug in to their trenches. But watch the next rounds: how Washington and Brussels handle this case in the next few weeks will speak volumes about the capacity of the United States and Europe to handle their toughest problems in a cooperative way.

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