

Chapter 4: Comparison of Major Program Structures

Section A: Large Aircraft

Introduction

The economic and strategic importance of the civil aircraft manufacturing industry within the United States and Europe, together with the significant cost of large commercial aircraft and the long useful life of large commercial aircraft has justified a separate Annex to the OECD Arrangement setting forth the terms of, and procedures for, ECA-supported aircraft financings (the Civil Aviation Annex). The section of the Civil Aviation Annex that pertains to "large aircraft" is known as the Large Aircraft Sector Understanding, or LASU, with "large aircraft" defined as airplanes with 70 seats or more¹. Today there are two primary producers of large aircraft in the world: Boeing in the United States and Airbus SAS (Airbus) in Europe; however, in the future, both Bombardier in Canada and Embraer in Brazil will also produce "large aircraft" (i.e., regional jets with at least 70 seats). Accordingly, the current participants to the LASU are the United States and the European Union, which, in this context, represents the interests of France (Coface), Germany (Hermes) and the United Kingdom (ECGD) (collectively, the "Airbus ECAs"), the primary locations of Airbus production; however, in the future, Canada (EDC) and Brazil (BNDES and SBCE²) may become more involved in the LASU.

The LASU establishes the terms and conditions of export credit support that OECD governments can extend to buyers of large aircraft. It sets a minimum cash payment of 15%, an interest rate structure for ECA direct loans (set at 120 basis points and 175 basis points over 10-year Treasuries for 10- and 12-year repayment terms, respectively) and a maximum 12-year repayment term. The Civil Aviation Annex also sets forth the terms of, and procedures for, ECA-supported financing of spare engines and spare parts related to large aircraft. The LASU bans ECAs from providing support for large aircraft into producer country markets (also known as "home market countries", which currently includes the United States, France, Germany and the UK and, as a result of a separate agreement between the Airbus ECAs and Ex-Im Bank, Spain). Finally, the LASU prohibits tied aid financing for large aircraft.

As illustrated in **Figure 10**, Boeing and Airbus have accounted for approximately equal shares of large aircraft orders over the past five years; however Airbus has received more orders than Boeing in four out of the most recent five years. The results during the past five years reflect the highly competitive nature of the large civil aircraft manufacturing industry.

Figure 10: Orders of Large Commercial Jet Aircraft

	1999		2000		2001		2002		2003		Total	
	#	%	#	%	#	%	#	%	#	%	#	%
Boeing	391	45%	611	54%	334	47%	251	46%	250	47%	1,837	48%
Airbus	476	55%	520	46%	375	53%	300	54%	284	53%	1,955	52%
Total	867		1,131		709		551		534		3,792	

¹ Comparably sized aircraft configured for cargo operations are included in the definition of "large aircraft".

² BNDES (Brazilian Development Bank) and SBCE (Brazilian Export Credit Insurance Agency) are the two official providers of export credits for the Brazilian government. They operate similarly to Japan's JBIC and NEXI, i.e., BNDES provides direct loans and SBCE insurance coverage, often for the same transactions.

For several years, Boeing and Airbus have been the only manufacturers of large aircraft. However, as noted above, recently the regional jet manufacturers in Canada (Bombardier) and Brazil (Embraer) have begun producing large aircraft (i.e., regional jets with 70 or more seats). Although to date the primary market for both regional jets manufactured by Bombardier and Embraer has been U.S.-based airlines, the trends that led to regional jet purchases in the United States – bringing passengers from smaller cities to hub airports and more point-to-point flights between smaller city pairs – are likely to spread to markets overseas, where these large regional aircraft will be competing with the smallest U.S.-manufactured large aircraft. Accordingly, Ex-Im Bank will closely monitor the terms and conditions offered by the Canadian and Brazilian export credit agencies (i.e., EDC and BNDES/SBCE) in Ex-Im Bank's traditional aircraft finance markets. Moreover, if discussions to update the LASU begin in 2004, the United States expects that both Canada and Brazil will take part in these discussions.

Ex-Im Bank's Policy and Practice

Ex-Im Bank support for large aircraft transactions is provided almost entirely through its guaranteed loan program. Under this program, Ex-Im Bank provides a 100% unconditional payment guarantee of the repayment of principal plus interest at the contractual rate. As a result, this program results in attractively priced financing on the Ex-Im Bank guaranteed portion of the transaction.

In January 2003, Ex-Im Bank announced that it would reduce by one-third (1/3) its exposure fee on asset-based aircraft transactions for airlines based in countries that adopt, ratify and implement the Cape Town Treaty (including certain optional provisions). The Cape Town Treaty is an international treaty that will facilitate asset-based financing and leasing of large commercial aircraft by reducing the risk in cross-border asset-based aircraft financing. Ex-Im Bank believes the decrease in risk due to the improved legal environment resulting from the adoption and ratification of the Cape Town Treaty justifies the exposure fee reduction. During 2003, airlines in three countries (Panama, Ethiopia and Pakistan) qualified for the exposure fee reduction with respect to the export of a total of 13 aircraft. Unless otherwise extended, the exposure fee reduction incentive is currently set to expire on September 30, 2004.

Airbus ECAs' Policies and Practices

The Airbus ECAs made three major changes to their aircraft financing programs in 2003, all of which should result in a more "level playing field" between Ex-Im Bank supported Boeing aircraft and Airbus ECA supported Airbus aircraft. First, during 2003, both Coface and Hermes began offering a 100% unconditional guarantee for aircraft finance. Historically, both Coface and Hermes had offered a 95% conditional insurance product, which resulted in higher interest rates than under Ex-Im Bank's and ECGD's 100% unconditional guarantee programs.

Second, in the past, if the buyer entered into a purchase contract with Airbus, the Airbus ECAs allowed buyers of large aircraft to "lock-in" a fixed interest rate up to three years prior to the delivery of the aircraft at no cost to the buyer and without any obligation to use such "locked in" fixed interest rate financing. Beginning in 2003: (1) the Airbus ECAs abandoned this "free"

interest rate lock, which had provided a potential significant advantage to Airbus over Boeing and was quite costly to the Airbus ECAs; and (2) the buyer of the aircraft must now use the Airbus ECAs' pure cover program, which enables the buyer to choose either a fixed or floating interest rate but does not permit the buyer to set the fixed interest rate far in advance of the delivery date for the aircraft at no cost to the buyer.

Third, during 2003, all of the Airbus ECAs generally began to charge a one-time, 3% upfront risk premia on their financings of large aircraft.

Taken together, all three of these changes in the Airbus ECAs' financing practices related to large aircraft should result in a financing package that is more similar to that offered by Ex-Im Bank. Thus, the opportunity for either the Airbus ECAs or Ex-Im Bank to gain a competitive edge due to advantageous financing techniques appears to be fading.

Summary Data

Several factors contributed to a very challenging operating environment for airlines during 2003, although some of these factors had improved toward the end of the year: the outbreak of SARS during the winter of 2002-2003; the uncertainties leading up to the hostilities in Iraq; the continuing terrorist threat to the international airline industry; major airline bankruptcies in the United States and Europe; soaring fuel prices; and competition from low-cost airlines. This environment resulted in a contraction in or, in some cases, a total withdrawal from, the commercial aircraft finance market by private sector financial institutions. In addition, given that many of these factors had a direct, negative impact on airlines based in the United States, Boeing (and Airbus) delivered an unusually high percentage of their aircraft to airlines outside of the United States. This is evidenced by the increased percentage of deliveries of aircraft to foreign buyers during 2003 as shown in **Figure 11**. During 2003, Boeing delivered a total of 281 commercial aircraft (down 24% from the prior year) of which 153 (or 54%) were delivered to foreign buyers. Exports (by number of aircraft deliveries) have accounted for a growing portion of Boeing's deliveries since 2001, exceeding 50% for the first time in 2003. While the percentage of Boeing's foreign sales supported by Ex-Im Bank averaged approximately 25% between 1999 and 2001, it increased to 41% in 2002 and to 48% in 2003.

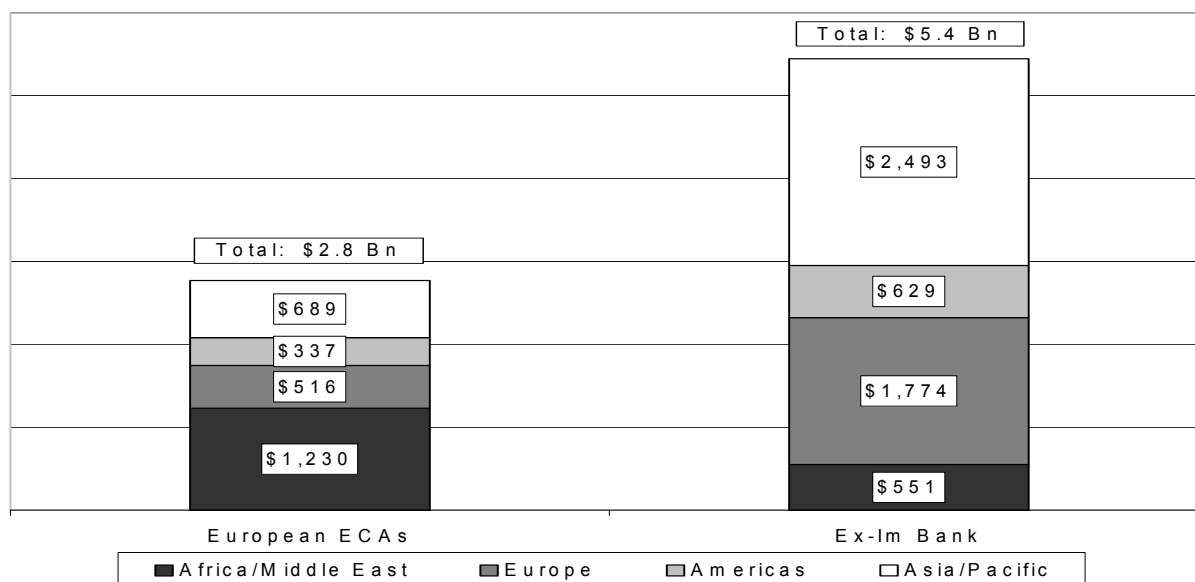
Figure 11: Deliveries of Boeing Commercial Jet Aircraft

	1999		2000		2001		2002		2003		Total	
	#	%	#	%	#	%	#	%	#	%	#	%
Domestic	356	57%	283	58%	363	69%	203	53%	128	46%	1,333	58%
Foreign	264	43%	206	42%	163	31%	178	47%	153	54%	964	42%
% Foreign supported by Ex-Im Bank	27%		27%		23%		41%		48%		32%	
Total	620		489		526		381		281		2,297	

As shown in **Figure 12**, Ex-Im Bank and the Airbus ECAs financed the export of approximately \$8.2 billion in large aircraft during 2003. Ex-Im Bank supported the export of more aircraft

during 2003 than during any year in Ex-Im Bank's history except for 1999,³ even though the overall number of Boeing aircraft that were delivered during 2003 (281) was down significantly from its all time peak in 1999 (620). In 2003, Ex-Im Bank accounted for \$5.4 billion (or 66%) and the European ECAs accounted for \$2.8 billion (or 34%) of the \$8.2 billion total ECA supported exports of large commercial aircraft.

Figure 12: 2003 ECA Support for Large Commercial Aircraft by Region



Exporter and Lender Survey Results

Exporters and lenders generally find Ex-Im Bank's aircraft financing program to be quite competitive with the Airbus ECAs' aircraft financing program. In particular, Ex-Im Bank received very high marks for its Cape Town Treaty initiative, in which it offered to reduce exposure fees by one-third (1/3) for asset-based transactions for airlines based in countries that ratified and implemented the Cape Town Treaty (including certain optional provisions). Ex-Im Bank's willingness to guarantee loans denominated in currencies other than U.S. dollars is also viewed as highly competitive with respect to the financing of large aircraft.

There are three areas where Ex-Im Bank does not fully meet the competitive needs of exporters. First, Ex-Im Bank's foreign content policy has been a source of concern for some time, with one respondent noting that the rules "mildly disadvantage" U.S. exporters. A second continuing problem, although not as significant a threat in 2003 as in previous years, is KfW's market window support (see Chapter 5, Section B) for Airbus, which provides additional financing capacity on top of that already available from the Airbus ECAs⁴. Finally, U.S. engine manufacturers and overhaul service providers find the long-standing U.S. government "Airbus Policy" – preventing Ex-Im Bank from financing any U.S. content on any Airbus aircraft – to be

³ The 1999 peak occurred as a result of: (1) the need for Ex-Im Bank aircraft financing following the Asian financial crisis in 1997-1998; and (2) a very large aircraft financing for a Middle East airline.

⁴ As explained in Chapter 5, KfW is undergoing a reorganization, the competitive implications of which are as yet unclear.

a competitive disadvantage (Airbus ECAs will finance U.S. content on new Airbus aircraft and European content on Boeing aircraft). One survey respondent indicated that after-market services and engine refurbishment deals had been lost to ECGD-supported competition due to this policy. With the exception of this one survey respondent, which graded the Bank's large aircraft financing program negatively due to the effect of the Airbus Policy on component sales, Ex-Im Bank's large aircraft program users found the Bank either fully or generally competitive with its European competitors

Conclusion

Ex-Im Bank continues to provide aircraft financing support that is competitive with that provided by the Airbus ECAs. Aspects of Ex-Im Bank's standard export credit support that are generally viewed as competitive, such as exposure fees and foreign currency guarantees, contribute to the competitiveness of Ex-Im Bank's aircraft finance program. The potential competitive hindrances to Ex-Im Bank's aircraft finance program, as noted by the U.S. exporting community, are the Bank's foreign content policy, market windows and Ex-Im Bank's inability, for larger U.S. government policy reasons, to finance U.S. content on Airbus aircraft.

The two competitive dynamics to watch over the next year are the impact of the Airbus ECAs' program changes and the emergence of Bombardier and Embraer into the large aircraft sector. Ex-Im Bank expects large aircraft competition based on export credit financing to be neutralized with the Airbus ECAs' abandonment of the three-year fixed interest rate lock and Coface's and Hermes' introduction of the 100% unconditional guarantee program for aircraft export credits. On the other hand, Brazilian and Canadian large aircraft exports that receive official export credit support – which might not necessarily comply with the Arrangement – could provide a competitive challenge to the smaller jets offered by both Airbus and Boeing.

