

## Part 2: Official Export Credit for Large Commercial Aircraft

### INTRODUCTION

#### Large Commercial Aircraft

In the context of officially supported export credits, the term “large aircraft” refers to airplanes with 70 seats or more<sup>1</sup>. Today there are two primary producers of large aircraft in the world – Boeing in the United States and Airbus Integrated Company (Airbus) in Europe. Airbus is a corporation owned by two European aerospace companies: the European Aeronautic Defence and Space Company (EADS; the result of a merger in 2001 between Aerospatiale-Matra of France, DaimlerChrysler Aerospace of Germany and CASA of Spain) and BAE SYSTEMS of the United Kingdom. The Russians also build large aircraft, however, their products do not compete globally with U.S.- and European-produced aircraft.

As illustrated in **Figure 9**, Boeing and Airbus have accounted for roughly equal shares of large aircraft orders over the past five years. This 50/50 split of orders reflects the highly competitive environment in which large aircraft manufacturers operate. The downward trend in orders that began in 2001, and that is expected to continue over the near term, creates additional competitive pressure on both Boeing and Airbus to provide aircraft that meet their customers’ technical requirements, at the lowest possible price and with an attractive financing package.

**Figure 9: Orders of Large Commercial Jet Aircraft**

	1997	1998	1999	2000	2001
Boeing	568 (55%)	656 (54%)	391 (45%)	611 (54%)	334 (47%)
Airbus	460 (45%)	556 (46%)	476 (55%)	520 (46%)	375 (53%)
Total	1,028	1,212	867	1,131	709

#### U.S. Aerospace Industry

The aerospace industry is associated with high-skilled and high-paying jobs that contribute significantly to U.S. economic growth and national security interests. In terms of international trade, the aerospace sector consistently generates a net positive impact on the U.S. trade balance. During 2000 and 2001, U.S. civil aerospace exports exceeded U.S. civil aerospace imports by \$21.7 billion and \$21.9 billion, respectively. Boeing is both the largest U.S. aerospace company and the largest U.S. exporter. During 2001, Boeing delivered 526 commercial aircraft of which 163 (or 31%) were delivered to foreign buyers. Exports (by number of aircraft deliveries) have accounted for 30% or more of Boeing’s deliveries since 1998 and Ex-Im Bank has supported

<sup>1</sup> Comparably sized aircraft configured for carrying cargo are also included in the definition of large aircraft.

approximately one-quarter of Boeing's export deliveries over each of the past four years (see Figure 10).

**Figure 10: Deliveries of Boeing Commercial Jet Aircraft (By Number of Aircraft)**

	1998	1999	2000	2001
Domestic	252 (45%)	356 (57%)	283 (58%)	370 (70%)
Foreign	311 (55%)	264 (43%)	206 (42%)	157 (30%)
% of Foreign Deliveries Supported by Ex-Im Bank	20%	27%	27%	32%
Total	563	620	489	527

Availability of term financing is a key variable that impacts the success of the U.S. aerospace industry in winning export orders. Accordingly, international disciplines exist for officially supported export credits for large aircraft. These guidelines were established under the auspices of the OECD. The specific OECD guidelines are summarized below, followed by a description of how the U.S. and European export credit agencies implement these guidelines and the volume of large aircraft supported through officially supported export credits.

## **EVALUATION OF OBJECTIVE DATA**

### **The Large Aircraft Sector Understanding**

Because the financing requirements of large aircraft exports differ from other manufactured products (e.g., significant capital costs and a longer useful life may justify longer repayment terms), the U.S. and European export credit systems negotiated an Annex to the OECD Arrangement dedicated to civil aircraft issues. The section of the Civil Aircraft Annex that pertains to large aircraft is known as the Large Aircraft Sector Understanding, or LASU for short. The principal participants to the LASU are the United States and the European Union, which, in this context, represents the interests of France, Germany and the United Kingdom.

The LASU establishes the terms, conditions and special guidelines of export credit support that OECD governments can extend to buyers of large aircraft. It sets the minimum cash payment of 15%, a market-based interest rate for loans extended by an export credit agency (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. It also limits the amount of spare parts that can be included in the financing package and generally bans ECAs from providing tied aid financing for aircraft.

### **International Negotiations**

While Ex-Im Bank and the European ECAs that support Airbus met regularly (two to three times per year) during the 1990's in an attempt to update the LASU (particularly with respect to establishing a risk-differentiated fee system), there have not been any formal bilateral meetings since June 1999.

## **Export Credit Agency Practices**

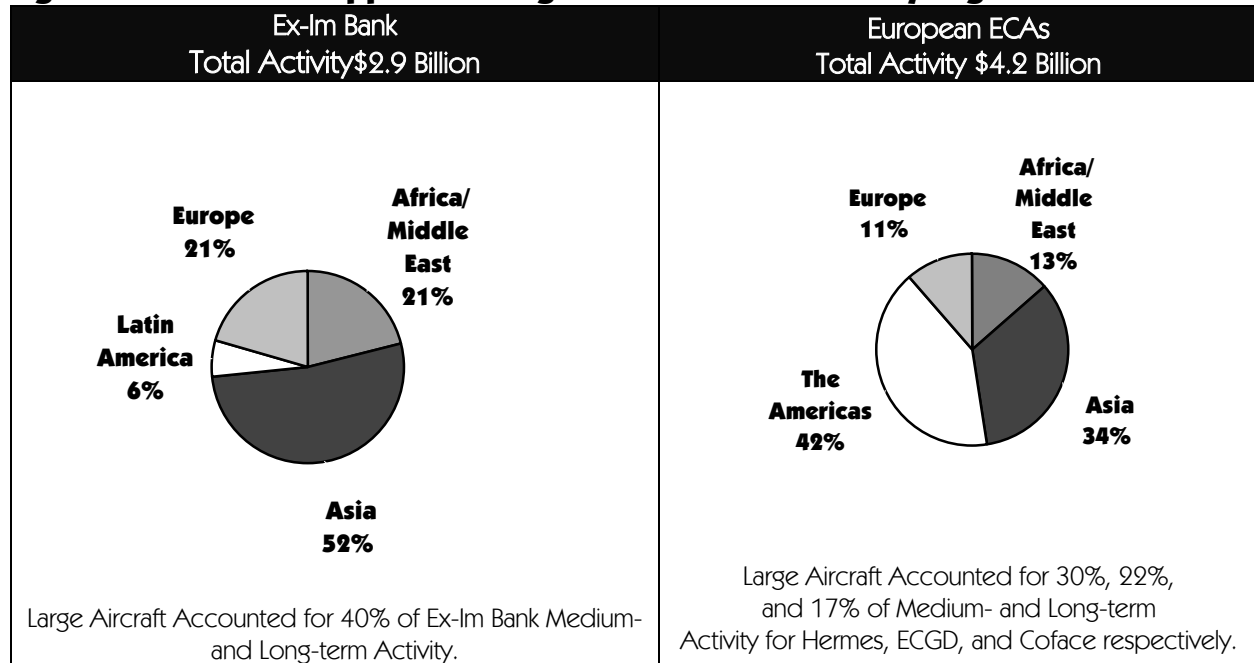
Although Ex-Im Bank and the European ECAs are subject to the same OECD guidelines, there are differences in the financing techniques each export credit system uses to support large aircraft transactions. These differences enable each side to capitalize on the relative strengths of its respective export credit system. For example, nearly all Ex-Im Bank support for large aircraft is done through the financial guarantee program, a financing option that provides lenders with 100% unconditional cover. This approach yields attractively priced financing on the Ex-Im Bank covered portion of the transaction.

The European ECAs provide a combination of insurance and guarantee support and offer financing enhancements, such as a free interest rate option. This option allows buyers to lock-in a fixed interest rate up to three years prior to delivery, provided the buyer has entered into a purchase contract with Airbus. Buyers may choose between this locked-in interest rate or another market-determined interest rate established between the time of contract signing and delivery of the aircraft. In a rising interest rate environment, the free interest rate option could yield significantly lower financing costs to the foreign buyer. Even in an interest rate environment in which the prevailing interest rates are falling or stable, the option is still an attractive feature of the European program since it represents a free hedge against rising interest rate costs.

The three European ECAs that support Airbus export sales have announced their intention to revise their official financing programs (including a modification to the duration of the free interest rate option) for large aircraft exports. These changes, which the Europeans will likely implement over the next year, are expected to yield financing terms and conditions that are more closely aligned with the Ex-Im Bank approach (e.g., shifting from a conditional insurance product to a guarantee product).

## **Export Credit Agency Activity**

As shown in **Figure 11**, Ex-Im Bank and the European ECAs that support Airbus financed more than \$7 billion in large aircraft exports during the calendar year 2001. Of that amount, Ex-Im Bank accounted for \$2.9 billion (or 41%) and the European ECAs accounted for \$4.2 billion (or 59%). Large aircraft transactions supported by Ex-Im Bank were concentrated in Asia (52%), followed by Africa/Middle East and Europe (each accounting for 21%) and Latin America (6%). European ECA activity for large aircraft was distributed across regions as follows: the Americas (41%), Asia (34%), Europe (11%) and Africa/Middle East (14%). As noted, large aircraft support accounts for a significant share -- between 17% and 40% of medium- and long-term activity -- of all four ECAs that support the large aircraft sector.

**Figure 11: 2001 ECA Support for Large Commercial Aircraft by Region**

## EVALUATION OF SUBJECTIVE DATA

Although there were only two survey responses that addressed the competitiveness of Ex-Im Bank programs and policies for large aircraft exports, the comments addressed several key issues. Specific comments included:

- ◆ The “financial” cost of Ex-Im Bank financing (i.e., interest rate and exposure fees) is competitive with the cost of financing provided by the European ECAs that support Airbus. On the other hand, the nature and cost of legal documentation associated with Ex-Im Bank financing appear to be more complex and more expensive when compared with the European export credit system. *[Note: Because legal fees are not governed by international agreement, the cost competitiveness of Ex-Im Bank in this area is not known. However, the LASU interest rate system, which yields margins of either 120 basis points for 10-year repayment terms or 175 basis points for 12-year repayment terms over 10-year treasuries, may provide a non-transparent means by which legal fees are charged on European-ECA supported large aircraft transactions. If so, these amount could easily rival the legal fees associated with Ex-Im Bank supported large aircraft transactions.]*
- ◆ With respect to foreign content, the European ECAs provide more flexibility (for example, the European ECAs finance the cost of U.S. engines on Airbus aircraft). Ex-Im Bank’s willingness, beginning in 2001, to allow foreign content to be calculated on an aggregate basis provides limited benefit to large aircraft transactions. Increasing the maximum foreign content allowance (without a reduction in cover) from 15% to 25% would benefit the aerospace industry.

- ◆ Regarding market windows, the survey respondents indicated that the lack of transparency associated with KfW financing prevents a definitive assessment of how market windows affect U.S. competitiveness. Nevertheless, anecdotal evidence suggests that KfW is a very important source of financing for Airbus aircraft.
- ◆ Improved Ex-Im Bank support for spare engines and spare parts (particularly in asset-based financing structures) would benefit the U.S. aerospace industry.

## **CONCLUSION**

Ex-Im Bank financing for large aircraft exports is generally competitive with financing offered by its European counterparts. While the comments from the export community indicated that certain elements of Ex-Im Bank financing could be improved (e.g., lower legal fees and increased support for foreign content and spare engines/parts), the export community did not cite issues related to Ex-Im Bank financing as a reason for any lost U.S. export opportunity.

Over the next year, changes to the European system, which could have implications for Ex-Im Bank policies, procedures and overall competitiveness, are likely to emerge. As such, Ex-Im Bank will consult regularly with the European ECAs and monitor any changes the Europeans ECAs make with respect to financing for large aircraft exports, including the impact of market window financing on the U.S. large aircraft sector.