

Testimony for Robert (Bob) Morin Before the U.S. International Trade Commission
Re: Competition and Export Credit in the Business Jet Aircraft Market
Wednesday, September 28 at 9:30 a.m.

Chairman Okun, Vice Chairman Williamson, and Commissioners: thank you for inviting me here today to discuss the competitive structure and recent developments involving the global business jet aircraft industry. As Vice President of the Transportation Division at the Export-Import Bank of the United States, I am responsible for overseeing the Bank's financing program for U.S.-manufactured aircraft to buyers around the world. In this role, I have witnessed, first hand, the vital role that a thriving business jet manufacturing industry plays in U.S. economic development and job creation. I have also witnessed how foreign competitors and their home governments have approached what has become a highly competitive market. As I will outline today, the current industry structure and outlook warrants a larger role for Ex-Im Bank to ensure a level playing field for U.S. business jet manufacturers in what is expected to be a growing market.

In 2009, the business jet aircraft industry experienced a significant downturn in the wake of the financial crisis. During the subsequent global recession, demand from price sensitive customers declined – especially affecting sales of light and medium-sized business jets – and available credit from private markets largely dried up. While sales continue to be sluggish in 2011, industry experts expect growth in deliveries to begin in 2012, barring another credit crisis or double dip recession, and continue for the foreseeable future.

As the business jet recovery unfolds, Ex-Im Bank expects the proportion of deliveries going to markets outside of North America and Europe to increase. That trend appears to have already begun in recent years, with the percentage of total deliveries going to North America and Europe declining from 83% in 2007 to 65% in 2010. China, India, Russia, Turkey, and Brazil are expected to be especially high-growth markets in the near future, as wealth creation and infrastructure improvements create new opportunities for business aircraft purchases in these countries.

While the market for U.S.-manufactured business jets has the potential to return to the 2007/2008 levels in the next ten years, a difficult credit environment in key growth markets could negatively affect that outlook. Although lending activity abroad began to increase before the downturn, only two significant financiers of business jet exports have continued to be active throughout the credit crisis. These lenders prefer to provide financing for larger-sized business jets, where demand comes from the "best credits," such as the world's wealthiest individuals and top corporations. Additionally, these lenders tend to only finance jets in countries viewed as a safer risk for repossession, mainly the United States, Canada, Western Europe, Australia, and South Africa. Although there were some preliminary indications that other lenders might be returning to or entering this market, the worsening European credit crisis puts this potentially favorable development at risk.

Even the best credits in other regions have had difficulty obtaining financing, and persistent caution brought about by the credit crisis is unlikely to improve that situation. While Ex-Im Bank expects that available credit will eventually be expanded, it may take 15 or more years for this to occur in most of Africa and certain Latin American and Asian countries. Because many prospective buyers abroad, especially businesses, may have other uses for their cash than to pay for these aircraft, a number of transactions that would have added value for buyers and manufacturers may be forgone.

Amid this picture of a shifting export market with tight credit availability, there is also an evolving competitive environment among manufacturers. The business jet manufacturing industry was once concentrated in the United States and specifically in Wichita, Kansas, which resulted in Wichita being known as the "aviation capital of the world." This was evidenced by a report issued by the Brookings Institute in 2010 (based upon data from 2003 through 2008) in which Wichita was the leading city for exports as a percentage of gross metropolitan product, and the city with the fastest export growth. However, that world is changing.

Foreign manufacturers, such as Bombardier of Canada, Dassault of France, and Embraer of Brazil, have garnered higher shares of what was previously a U.S.-based and led industry. This has been especially true in recent years. In 2006, Embraer and Dassault were responsible for about one tenth of total business jet deliveries. In 2010, they represented about one third. Bombardier's share of deliveries has not drastically changed over this time; however, the company is poised for additional growth with its larger business jet line.

Part of this trend can be explained by Cessna and Hawker Beechcraft's focus on the small-to-medium end of the business jet market, which was particularly affected during the downturn. Nonetheless, the primary foreign manufacturers Bombardier, Dassault, and Embraer all have close ties with their respective export credit agencies and have been using the financing benefits these agencies bring to the table to increase sales, especially in recent years.

For example, Embraer's deliveries of its Phenom 100 very light jet increased from 2 in the first production year of 2008 to 97 in 2009 and 100 in 2010. This strong growth came at a time of sluggish sales for other light and very light jets. During this time, and continuing into 2011, buyers of Embraer aircraft have benefitted from available financing on favorable terms through BNDES, Brazil's export credit agency.

A key point to note is that BNDES has a special program to provide financing for Phenom jets being delivered to domestic Brazilian customers. While participating export credit agencies traditionally follow the guidelines set forth by the OECD for financing exported aircraft, BNDES provides more favorable terms than the OECD guidelines under the justification that the financing of domestic sales is not bound by the terms of the OECD's Aircraft Sector Understanding. The OECD's negotiation of a new Aircraft Sector Understanding, in which Brazil participated as a non-member, grew out of a desire by all participants to create a level playing field for financing in all regions of the world. Providing better financing terms for lending into one's "home market" (for example, Brazil, in the case of BNDES) contradicts this fundamental principle.

While knowledge of the exact details and terms of this special financing program is limited, any financing arrangement that falls outside of the OECD guidelines also has the potential to create market distortions that can lead to an undue competitive disadvantage for U.S. manufacturers. If there is one lesson that the credit crisis has taught the business jet aircraft industry, it is that available financing at reasonable terms is one of the key factors in completing a sale. Government-supported programs that provide more attractive terms than a competitor can offer are therefore very likely to lead to a non-level playing field that favors certain manufacturers. Accordingly, it is reasonable to assume that the special BNDES domestic financing program for Embraer aircraft is one important element that helps explain the strong performance of Embraer in Brazil at the smaller end of the market. Performance due to such factors is likely to come at the expense of other manufacturers that can only rely upon commercial financing or export financing on terms that are consistent with the OECD Aircraft Sector Understanding.

Foreign business jet manufacturers also have a competitive financing advantage when selling into the U.S. market. Embraer, Bombardier and Dassault can each offer foreign government-supported export credit financing of their business jets to their U.S. customers, whereas the U.S. business jet manufacturers have to rely upon commercial financing, or, in the case of Cessna, a captive finance company, to finance their sales in the United States.

For example, earlier this year, the second largest private aviation company in the United States announced that it had entered into a \$167 million arrangement with BNDES to finance a significant portion of its order of up to 150 Brazilian-manufactured Embraer Phenom 300 aircraft. Because Ex-Im Bank only finances exports of U.S.-manufactured business jets, Ex-Im Bank was unable to provide comparable support for any of the U.S. business jet manufacturers that may have been competing for this order.

Of the total number of Embraer Phenom aircraft ordered and/or delivered, a significantly higher percentage of such aircraft are to buyers in either Brazil or the United States, which are the two markets in which BNDES provides Embraer with a competitive financing advantage in comparison with the terms available through private markets or Ex-Im Bank supported financing.

Although Ex-Im Bank does not finance domestically sold products and complies with guidelines negotiated and agreed to by the members of the OECD for all of its transactions, Ex-Im Bank has been increasing its activity in the business aircraft market to fill a financing gap during the recent credit crisis and resulting downturn in the business aircraft industry. Prior to the credit crisis, during fiscal year ended September 30, 2008, Ex-Im Bank approved financing aggregating less than \$20 million with respect to business aircraft. During the credit crisis, the amount of Ex-Im Bank supported financings for business aircraft jumped to more than \$600 million, which included a \$500 million facility to Textron Financial to support the sale of Cessna aircraft. For fiscal years 2010 and 2011, Ex-Im Bank supported financings for business aircraft have continued at elevated levels in comparison with pre-credit crisis levels, totaling approximately \$250 million for these two years.

Given (1) the growth of foreign business jet manufacturers, (2) the increased use of official export credit by these foreign manufacturers, (3) a shift in growth to developing markets, and (4) the lack of available commercial credit in those growing markets, there is an increasing role for Ex-Im Bank to play in order to help ensure a level playing field among global business jet aircraft manufacturers. The business jet market is highly competitive, and all business jet products are very well designed and manufactured for their respective market segments. Ex-Im Bank is confident that U.S. products compare very favorably on the global market, but Ex-Im Bank is concerned about the competitive effects of access to financing, or access to financing on better terms, through export credit agencies, development banks or other government-supported financing institutions or programs. It is important that competition is based on aircraft product attributes, price, operating costs, and technology rather than the availability and terms of financing.

While Ex-Im Bank believes that private banks will fill the temporary void for larger-sized business aircraft in developed countries, a financing gap will no doubt persist in developing countries that represent high growth markets. The market is almost certain to continue to see more use of the Brazilian, Canadian, and French export credit agencies to support their home manufacturers' products to capture a greater share of this lucrative market, especially since the private commercial markets will be inadequate to provide financing in developing countries. Without Ex-Im Bank's assistance, therefore, it is likely that

the market for small- and medium-sized jets will be disproportionately filled by business jets produced by foreign manufacturers.

Additionally, increased Ex-Im Bank support is necessary to ensure that American business jets continue to be manufactured in the United States, an important source of economic activity for the American economy. General aviation is a high-technology industry that is intensive on engineering and innovation. The industry contributes \$150 billion to the U.S. economy annually, supporting approximately 1.2 million jobs. While general aviation manufacturers directly employ between 120,000 and 130,000 U.S. workers, they have suffered during the downturn, resulting in 20,000 manufacturing layoffs since 2008. Cessna is now building entire aircraft in China, and Learjet, Cessna and Hawker Beechcraft are each moving manufacturing functions and jobs to Mexico. Ex-Im Bank understands it needs to continue to increase support for this industry to help insure that the premier business jets flying around the world remain "Made in the USA."

To summarize, the business jet market is currently in a state of transition, with the highest growth markets shifting to developing economies and manufacturers attempting to recover from a serious downturn. Amid this change, there is a lack of sufficient credit, especially in the highest growth markets. While export credit agencies are important tools to fill such a gap, there are indications that certain buyers benefit from government-supported financing programs that provide more favorable financing terms than those set forth in the OECD Aircraft Sector Understanding. Moreover, in the U.S. market, where Ex-Im Bank has no ability to readily finance sales of U.S.-manufactured aircraft to U.S.-based customers, foreign manufacturers and their official export credit agencies are offering terms that are not available on a commercial basis.

While it is only natural for companies from growing economies to enter the business aircraft market, such competition should unfold on a level playing field. Any program that varies from internationally negotiated standards to provide more favorable financing terms has the potential to unduly influence purchasing decisions and distort the natural competitive process, which is primarily based on aircraft price and quality.

As previously mentioned, Ex-Im Bank believes that the U.S. business jet manufacturing industry compares favorably with other international business jet manufacturers. Ex-Im Bank is committed to doing everything it can to ensure that the lack of available financing and the terms of such financing do not discourage potential transactions, and that U.S. business jet manufacturers are able to compete based on the strengths of their products.

Once again, I thank you for the opportunity to testify, and I am open to any questions you may have.