

Deregulation brings an end to U.S. commercial aircraft orders

by Leif Johnson

The \$7 billion Boeing Company, the aircraft manufacturer that has produced 90 percent of the world's planes and still holds 90 percent of the U.S. market, is still officially unruffled by the state of the economy. Despite the disastrous profit-and-loss picture in the airline industry, despite the rash of order cancellations for the company's 757s and 767s, and despite the lack of any evidence that the market will improve, Boeing is sticking with its market projection of \$100 billion in aircraft sales over the next 10 years. And that \$100 billion is estimated in constant 1982 dollars.

H. C. Munson, Vice-President of Boeing for Strategic Planning, recently gave a Washington D.C. audience his reasons for optimism. "The underlying fundamentals which drive air travel are right. Society today is highly dependent on travel. And air transportation is by far the most convenient and economical means of travel over distance of any consequence."

Munson is correct; aircraft orders are sustained by increased airline traffic.

He continued, "The demographics are right. The portion of the population who are most likely to travel—those between the ages of 25 and 45—is the fastest growing segment of our population." Again the logic is beyond dispute, although this pent-up demand is exactly the premise of homebuilders' and automakers' hapless "it must get better" hopes.

Lastly, Munson said, "the propensity to travel is right. You may find it surprising when I say that the money spent on air travel has been increasing during a period when traffic is declining." Probably none of his audience at the International Club were surprised: fares have indeed gone up.

The most compelling argument Munson made in a

year-old Boeing document is that 2,000 of the world's aircraft will be 16 years old or more by the end of this decade, and therefore must be replaced. Munson reasons that demand will be on the scale of the huge jet orders of the early 1960s as airlines replaced propeller craft, or at least of the replacement of the original small jets by the wide-bodied fan jets in the early 1970s.

What even Boeing knows

Each annual issue of *Current Market Outlook*, a world survey published by Boeing's commercial airplane subsidiary, carries a chart of aircraft orders since 1965. The chart (see graphic) also shows airline profits since 1965. The almost complete coincidence between airline industry profitability and aircraft orders is remarkable, since needed replacement of capital equipment in most industries does not coincide so closely with periods of high profitability. As Boeing admits, each of its new aircraft was launched into a market on an upswing.

Nothing could be further from the case today. Since the halcyon pre-deregulation year of 1978, when domestic trunk lines alone gleaned over \$1 billion in operating profits, and U.S. international carriers took in another third of a billion, the airline industry's operating profits have fallen off the cliff. In 1979 operating profits tallied \$200 million; in 1980, the figure fell into a quarter of billion loss. Nineteen eighty-one saw a \$420 million loss, and the first quarter of 1982 a record \$586 million loss (see *EIR*, June 1).

Beyond the blue horizon

Steadily mounting deficits are translated into cancellations of aircraft orders. Boeing suffered a body blow

this February when American Airlines canceled its \$600 million order for fifteen 757s, a plane that Boeing had spent a billion dollars in developing. Of the remaining 123 orders for 757s, half are from Delta Airlines, which suffered its first major earnings loss in the first quarter of 1982. Boeing has nailed only eight orders for the 757 since the beginning of 1981, and the company has announced graduated layoffs of 8,000 to 10,000 employees at its Seattle and Wichita, Kansas manufacturing plants.

One aircraft analyst claims that the present rate of orders is so slow that Boeing could shut its 757 production line for a year and still meet those orders.

It may also close its 767 line as well. On May 26, United Airlines, the foremost champion of deregulation, announced that it is negotiating to delay delivery of 20 wide-bodied 767s and will probably cancel the remainder of the 39-craft order. United also threatened to cancel an additional nineteen 767s on order, bringing the total to 39 aircraft worth \$1.8 billion. United posted a 1981 loss of \$104 million and a record three-month loss of \$129 million for the first quarter of 1982.

If United cancels, Boeing is left with only 134 orders,

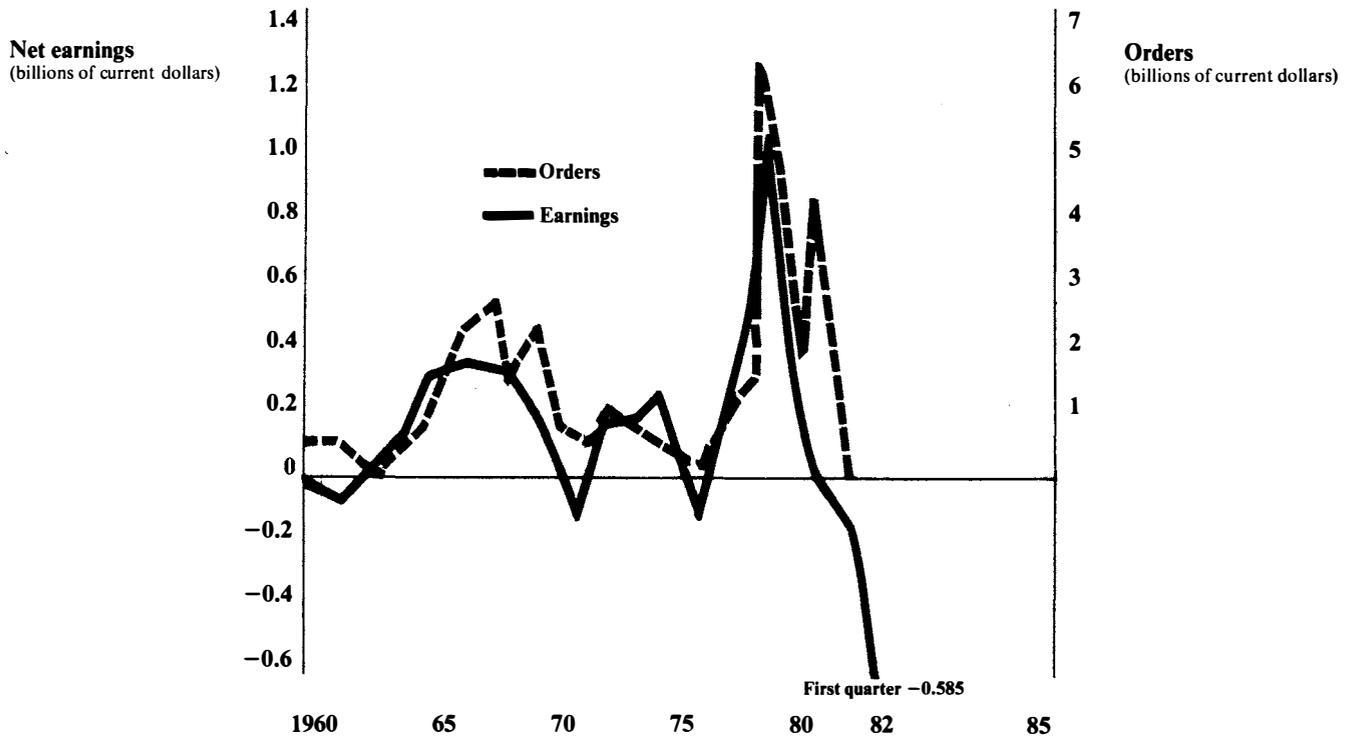
some as shaky as United's. Boeing may have embarked on aircraft production that will entail large expenses and obligations but too few orders to turn a profit.

Order terminations portend severe trouble for the other two American commercial aircraft producers. Lockheed has announced that it will halt production of its only commercial craft, the L-1011. The other major producer, McDonnell-Douglas, has too few DC-10 orders to stay profitable.

According to Boeing, the company—and presumably others as well—must sell 700 units to make the development of any specific aircraft profitable. As domestic airlines undergo a 25 percent shrinkage in revenue passenger miles, threatening the bankruptcy of major carriers like Pan-American and TWA, they will not order new aircraft. Nor will the non-union fringe airlines created by the same financiers who provide credit for the majors. These “new entrant” carriers allowed by deregulation mostly buy used aircraft 737s or DC10s from the failing major carriers.

If Boeing's order book for the 757s and 767s is so short of the 700 mark, and if domestic U.S. carriers, which provide one half the world's aircraft market, are

U.S. trunk airline earnings and new equipment orders



Source: Boeing Commercial Airplane Company



Thirty years of Boeing craft lined up near Seattle, Washington: third from last is the B-52, first delivered in 1954.

in a very poor position to buy aircraft, where does Boeing hope to make good its sunk development costs? The world market looks little better than the domestic one.

According to one industry analyst, the only nations that will definitely purchase new U.S.-made craft are the Gulf states, assuming no disruptions. Singapore Airlines and Cathay Pacific, both potential large purchasers, are looking for cheap 727-200s and used wide-bodied planes. The Africans will buy DC-8s and even the very old 707s. Much of the rest of the market, including the national airlines of South America and Asia, cannot sustain many new orders.

The European market is more a worry for Boeing than a source of expectations. The European national airlines were very badly hurt by the combined Freddy Laker-U.S. deregulation fare cutting, and do not look kindly upon U.S. aircraft manufacturers. Besides, they have their own aircraft, the A-300 Airbus, which is not only superior in design to the 757s but was designed specifically for European air routes.

According to a U.S. General Accounting Office report dated March 18, 1982: "The Department of

Labor estimated that the European Airbus Industries consortium captured approximately 38 percent of a traditional U.S. export market in the first half of 1979 with the A-300 Airbus. The Office of the U.S. Trade Representative believes this percentage is likely to increase over the next decade." A recent large Brazilian order of Airbuses confirms the trend in Airbus sales.

Airbus competition alone would not necessarily doom Boeing to unprofitability on its 757/767 lines if the Europeans were the only major commercial airframe competitors up to the year 2000. There are in fact financial ties running through Warburg banks that bind both companies together at the top. The question is whether any new technology will render the existing new planes obsolete.

Boeing admits that while the 757/767 is more efficient, it represents no technological improvement, as did the first jets over piston planes and the two-engined jet aircraft.

The fact that the 757/767s are merely modernized old planes is strikingly clear from a publicity photograph (see above) provided by Boeing. In the photograph is every model jet made by the company since

1954. But for size, they are basically the same aircraft with engineering modifications, the most important being much more efficient engines. Otherwise the aerodynamics and flight capabilities—these are all sub-sonic aircraft—as well as the construction techniques and materials are basically those that produced the Korean War-vintage B-52s.

Boeing is confident that no new technology will pop up. “Is there some external event ‘X’ during the next decade which, when combined with technology advancements, will make the airplanes currently being delivered to the airlines obsolete? Maybe, but we don’t think so,” they say in a February 1981 paper titled “Aircraft Economic Obsolescence.”

Boeing has reason for its happy belief that technological advances won’t engender competition. Since World War II, the United States has been the source of most aircraft technology, as the taxpayer funded it through military aircraft development. The jet age was created by the Air Force’s B-52, which became the Boeing commercial 707, and the widebody craft were created by the Air Force’s C-5A cargo plane development. But for the B-1, whose fate is still in doubt and which is not easily adaptable to commercial application, there is currently no military program in the works which will provide the new technology.

Boeing itself refused to promote one major technological advance, the supersonic aircraft (SST), which finally died in Congress. Thus it can say that there is no new technology between now and the end of the decade that will compete with what are now in fact obsolete planes being produced.

A whole range of technologies could be opened up, however. There are vertical takeoff and lift (VTOL) planes, new aerodynamic designs, the supersonic aircraft, very large carriers and freighters including atomic-powered ships, some of which could be built with molded bodies rather than riveted alloy bodies.

The only concern of Boeing, and also Airbus, is Japan’s aircraft industry. It was banned after World War II and began in a very limited fashion in 1954, servicing U.S. military aircraft. Today, still relatively small, it receives 86 percent of its orders for military aircraft parts.

The Japanese Ministry of International Trade and Industry has now made commercial aircraft development a priority for the Japanese economy. Boeing knows that means a full-scale commitment to produce in several areas of the market, from 70-seater commuter aircraft to direct competitors of the 757 and Airbus. Japan must enter the tight market with a superior aircraft, possibly one designed for subsequent modifications, making the Boeing and Airbus designs outmoded.

This has made Boeing howl. In March 1982 the

General Accounting Office, which provides anti-industrial “technical advice” to elected officials, issued a report entitled “U.S. Military Co-Production Programs Assist Japan in Developing Its Civil Aircraft Industry.” The report does not recommend a halt to military co-production or to co-production of the Boeing 767, but seeks to stamp out the possibility of Japanese-built “world class aircraft.” The GAO concludes, “The Department of State and Defense have not given adequate attention to the economic implications of co-production along with the political and military objectives. . . . The United States receives some economic benefits from co-production with Japan in the form of licensing and technical assistance fees. However, there could be long-term adverse effects on the U.S. economy. Co-production by definition involves the transfer of technology and industrial know-how. The transfer of military technology with commercial application could contribute to the erosion of our technology-based comparative advantage.”

Consider the assumption here: the United States will not use this technology in its own aircraft. The same assumption is clear in the Boeing document quoted above.

The second assumption is mere hypocrisy: namely, that the Japanese are using military production programs as the base for future commercial aircraft. How did the United States develop its commercial aircraft, or Great Britain, or France, or for that matter the Soviets? The GAO Report further misleads by failing to explain that the Japanese are seeking U.S. or European partners in their commercial aircraft bid.

In a letter to the GAO, Beatrice N. Vaccara, Director of the Bureau of Industrial Economics in the Department of Commerce, raised the alarm: “In our view, the report does not focus sufficient attention on Japan’s motivation in promoting the F-15 co-production agreement. Does the co-production under review represent another mercantilist ploy through which Japan seeks eventually to manipulate trade flows to the advantage of its national economy?”

Imagine that from the United States, which has maintained its monopoly of commercial aircraft sales by every imaginable means, having achieved an ascendancy far more complete than even IBM’s control of the world computer market. Boeing boasts, for example, that the U.S. aircraft industry, with \$12 billion a year in exports, is the largest single manufacturing exporter in the U.S. economy. Yet Japanese “mercantilist” efforts to bring advantage to its economy are deemed intolerable.

Undersecretary of Commerce Lionel Olmer—whose desire to crush Japanese industrial development, as expressed in an interview in the May 25 issue of *EIR*, is now becoming a scandal in Japan—said in a letter to

the GAO: "Commerce has been very concerned for some time with the ease with which Japan obtains a broad range of U.S. technology for virtually nothing and then uses it to become a fierce competitor. . . . It is apparent from the [GAO] report that Japan has used co-production as a means of obtaining high technology necessary for moving toward development of such an industry. It is also apparent that the flow of technology and overall benefits has essentially been one-way to Japan."

Olmer, who is here demanding curtailment of technology transfers, has not only been vociferous in demanding that Japan open all its markets, including its national banking system, to Dope, Inc.'s hot-money flows, but is now demanding a closure in sales of technology to that country.

If Boeing, the Commerce Department, and the Office of the Special Trade Representative are so concerned with Japan's technological applications, why aren't they demanding that Boeing, too, reach state-of-the-art production? Moreover, if Boeing is so concerned about Japanese competition in a tight market, why did Boeing simply watch the American airline industry collapse?

At no time did Boeing protest the easily anticipated results of deregulation. In the speech to the Internation-

al Club in Washington, D.C. cited earlier, Boeing's H. C. Munson declared, "When Senator [Howard] Cannon [D-Nev.] recently asked the ATA [Airline Transport Association] if Congress should consider re-regulating the airlines—the answer was categorically 'no.' I agree with the ATA's response to the Senator." Munson's solution for the horribly pinched industry was to use the multibillion tax rip-off known as the Safe Harbor Leasing (sale of tax credits by corporations in the red) contained in the 1981 Tax Recovery Act.

Boeing's failure to use its own most advanced technology in its commercial aircraft, its defense of deregulation, and its fear that Japan may enter the aircraft market can have only one explanation. Boeing is indifferent to the commercial aircraft market—as long as the Japanese don't enter it—and it will probably turn to military production for its profits. Like its earlier planes, the 757 and 767 are essentially military transport craft turned to commercial service.

At present, the only market that is expanding is the military. Boeing, Commerce, and Special Trade Representative's Office are concerned that Japan be maintained as a parts supplier, essentially integrated into the NATO procurement standardization. That means that aircraft and other industries would be stripped down to the level required for a shrunken, militarized economy.

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