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MAIN FEATURES OF THE EXCHANGE RATE SCHEME INTRODUCED BY
THE FEDERAL REPUBLIC OF GERMANY
FOR CERTAIN LARGE CIVIL AIRCRAFT

Communication from the European Communities

The following document was distributed by the delegation of the European Communities to Signatories attending the meeting of the Committee on 31 January 1990.

1. On 8 December 1989, the Government of the Federal Republic of Germany, Daimler Benz and Messerschmitt-Blohm-Blohm (MBB) finalized an agreement concerning the privatization of MBB and Deutsche Airbus. In this context, they agreed on the establishment of an exchange rate scheme. This scheme will be the only form of potential production support for the German partner in the latest Airbus programmes (that is, A 330/340) between now and the year 2000. From 1996 onwards it will also replace other forms of support for old programmes, when existing legal obligations expire. Thus, its function is only to assure a smooth transition for privatized German Airbus operations to a situation of complete absence of public support by the year 2000, as well as to allow the adaptations of the new private investors to a very special market situation: in other words, to reduce and finally to eliminate public support.

2. Even within this context, any possible intervention by the German Government would be limited and conditional. The scheme is designed to ensure that the industry itself bear a major portion of the exchange rate risk by means of a number of features of the scheme itself, notably limits on its operation and own contribution by the industry.

3. As far as the limits are concerned:

- The Government of the Federal Republic of Germany would only step in if the dollar/mark exchange rate were between DM 1.60 and 1.80 to the dollar. Under this scheme, the Government will in no case cover the portion of exchange rate losses due to a rate lower than DM 1.60 to the dollar, and the industry bears this risk in its entirety.
- Certain figures which have been quoted represent nothing more than a simple arithmetic calculation of a "worst case scenario", i.e. that of

an exchange rate constantly at DM 1.60 to the dollar or lower. This is not a realistic assumption, and it does not imply that the amount quoted would be disbursed.

- For the A 330/340 programmes, the coverage of the scheme (which will enter into operation in 1992) is limited to 75 per cent of the final exchange rate loss each year. This ceiling will then be reduced to 50 per cent for the years 1999 and 2000.
- Most important, whereas the obligation of the German Government expires in the year 2000, the industry has a corresponding obligation to repay the German Government of any intervention it may have made, using any exchange rate gains it will realize. This obligation does not expire in the year 2000, but will continue until all intervention by the Federal Government under this scheme has been entirely offset, and it is independent from whether Deutsche Airbus makes profits or not.

4. With regard to the industry's own contributions, we have already mentioned that losses due to an exchange rate lower than DM 1.60 to the dollar are not covered by this scheme. But even for the portion of the exchange rate risk which does fall within the scheme, there are other elements to take into account to calculate an exchange rate loss eligible for coverage within the limits mentioned before. The effect of these elements is to reduce the size of the loss eligible for coverage:

- Exchange rate losses or gains are calculated on a yearly basis. This means that exchange rate gains within the year are used to offset exchange rate losses over the same period.
- It is envisaged that the industry, if only because it bears a substantial part of the risk, will make use of all possibilities available in the private market to protect itself from a fluctuating dollar.
- Deutsche Airbus would not benefit from higher dollar receipts caused by inflation in the United States higher than current rates of inflation. In other words, the compensation effect of inflation

¹Older programmes (A 300/310 and A 320) will be covered by the same scheme, at the same conditions, from 1997 onwards, with the only difference that government intervention could be triggered by an exchange rate between DM 1.60 and 2.00 (rather than 1.80) to the dollar.

Until 1996, A 300/310 are covered by pre-existing legal obligations of the German Government. A 320 already in progress (that is, those contracts concluded before the end of 1988 when negotiations with Daimler Benz started, and whose deliveries are foreseen at the latest to end in 1996) receive a cover of exchange rate losses up to 100 per cent only until the end of 1996.

differentials between the United States and the Federal Republic of Germany would be taken into account in order to reduce the exchange rate loss eligible for coverage under this scheme.¹

- Even when the exchange rate is between DM 1.60 and 1.80 to the dollar, the industry must bear on its own exchange losses, up to DM 15 million per year, out of own funds that are already set aside. This sum must be used before any Government intervention takes place. If, in any given year, this amount is not used, or not entirely used, the balance has to be added to the following year's amount. Thus, in case there are losses all throughout the period, the industry's own contribution under this item can amount to DM 195 million.
- After 1996, the industry will have to use its profits, even those gained outside the Airbus programme, to offset exchange rate losses, before they become eligible for coverage by the scheme.

Finally, there is an additional element which, although not strictly linked to the exchange rate scheme, nevertheless has a bearing on it. MBB, as the parent company of Deutsche Airbus, will have to set up a special reserve, using its own profits to the extent of DM 15 million per year, to be kept available for immediate use, should insolvency threaten Deutsche Airbus, including the case in which such a threat arises from exchange rate losses.

¹The inflation in the USA would be calculated, for this purpose, according to the so-called "Boeing formula" (that is, a set of calculation to assess the effect of inflation specifically on the aircraft industry: a sort of sectoral inflation indicator). The compensation effect of the inflation differential is calculated and applied regardless of whether Deutsche Airbus actually receives higher US dollar amounts, and therefore is independent from Airbus' actual pricing policy.