

GERMAN EXCHANGE RATE SCHEME
FOR DEUTSCHE AIRBUS

Report by the Panel
(SCM/142)

1. INTRODUCTION

1.1 On 20 March 1989, the United States requested consultations with the European Economic Community ("EEC") under Article 12:1 of the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement (the "Subsidies Agreement"), regarding an Agreement between the German Government and Deutsche Airbus ("D.A.", the German partner of the Airbus consortium) on exchange rate guarantees in connection with Airbus aircraft programmes. These consultations, held on 9-10 May 1989¹, and additional discussions held subsequently did not result in a mutually acceptable solution to the matter. On 11 December 1989, the United States referred this matter to the Committee on Subsidies and Countervailing Measures (the "Committee") for conciliation pursuant to Articles 13:1 and 17:1 of the Subsidies Agreement (SCM/97). As the conciliation meeting held by the Committee did not lead to a satisfactory adjustment of this matter, the United States, on 14 February 1991, requested the establishment of a panel under Article 18 of the Subsidies Agreement to examine the matter (SCM/108).

1.2 At its meeting on 6 March 1991, the Committee agreed to establish a panel on the matter, and authorized its Chairman to conduct consultations on the terms of reference and composition of the Panel (SCM/M/49).

1.3 At its meeting on 11 April 1991, and in the absence of the parties' agreement on modified terms of reference², the Committee decided on the standard terms of reference provided in Article 18:1 of the Subsidies Agreement as follows (SCM/M/50):

Terms of Reference:

"The Panel shall review the facts of the matter referred to the Committee by the United States in SCM/108 and, in light of such facts, shall present to the Committee its findings concerning the rights and obligations of the signatories party to the dispute under the relevant provisions of the General Agreement as interpreted and applied by this Agreement."

1.4 The composition of the Panel was agreed on 17 April 1991 as follows:

Composition

Chairman: H.E. Mr. Julio Lacarte-Muró

Members: Mr. Pekka Huhtaniemi
Mr. Peter Hussin

1.5 The Panel met with the parties on 5 June, 17 July and 4 October 1991.

¹The EEC considered that these consultations were carried out without prejudice to their legal basis.

²Full details of the disagreement concerning modified terms of reference for the Panel are contained in the Minutes of the meeting (SCM/M/50).

2. FACTUAL ASPECTS

2.1 The following are the factual aspects of this dispute as the Panel understands them.

Establishment of the German exchange rate scheme

2.2 On 8 March 1989 the European Commission approved measures proposed by the Federal Republic of Germany regarding the privatization of Messerschmidt-Bölkow-Blohm (MBB) via its merger with Daimler Benz. These measures included the Agreement signed on 24 November 1989 between the Federal Republic of Germany and Deutsche Airbus on Exchange Rate Guarantees for the Airbus Programme (hereinafter referred to as the "scheme") concluded on the basis of the framework agreement between the Federal Republic of Germany, Daimler Benz, Messerschmidt-Bölkow-Blohm and Deutsche Airbus of October/September 1989.

2.3 Subsequently, an additional Agreement was concluded which relates to Paragraph 10 of the original Agreement, concerning possible arrangements for German equipment suppliers to the A320 programme. This additional Agreement was signed on 10 December 1990 and extends the scheme - on the basis of payments made directly by Deutsche Airbus to the qualifying suppliers - to certain German suppliers who deliver directly or indirectly to Deutsche Airbus or to partners in the Airbus consortium.

Applicability of the scheme

2.4 The scheme took effect on 8 December 1989 when the merger was approved. It provides that the German Government

"... shall, above a threshold of DM 1.60 to the US dollar, guarantee against any accounting shortfall in deutschemark earnings incurred by D.A. resulting from US dollar exchange rate losses in the course of:

(a) the A300, A310 and A320* programmes, should the dollar exchange rate fall below DM 2.00; and

(b) the A330 and A340 programmes, should the dollar exchange rate fall below DM 1.80."

Footnote: "*For the purposes of this Agreement A320 is the basic version and the A321 (originally the A320-stretched)."

(Article 1(1) of the Agreement)

"Exchange rate guarantees shall apply to D.A.'s net US dollar earnings in a given year from the Airbus programmes referred to in Article 1 which have been converted into Deutschemarks or other currencies."

(Article 2(1) of the Agreement)

"Net US dollar earnings shall be calculated by deducting from the total US dollar earnings of the different Airbus programmes the US dollar outgoings and any contributions (in US dollars) to the different Airbus programmes in US dollars purchased with Deutschemarks or any other currency."

(Article 2(3) of the Agreement)

"From 1 January 1997 compensation for exchange rate losses under the guarantee mechanism shall only be made if DA makes an annual deficit, excluding the amount of any adjustment under the guarantee system. The balance sheet and valuation provisions of the Framework Agreement shall also be taken into account for the purposes of calculating the relevant annual result."

(Article 15 of the Agreement)

"1. Under the exchange rate guarantee system the FRG shall offset exchange losses in the following way:

75% in the case of the A300 and A310 programmes in 1997 and 1998;

75% in the case of the A320 programme from the date of delivery of the 652nd aircraft - but no later than 1 January 1997 - up to 31 December 1998;

50% in the case of the A300/310 and A320 programmes in 1999 and 2000;

75% in the case of the A330 and A340 programmes up to 31 December 1998;

50% in the case of the A330 and A340 programmes in 1999 and 2000.

2. From 1 January 1997 the level of payments made by the FRG under the exchange rate guarantee system shall be confined to the level of the annual deficit to be calculated pursuant to paragraph 15."

(Article 16 of the Agreement)

The Agreement indicates that payments under the scheme shall be made out of the budget of the German Government.

2.5 The additional Agreement, relating to suppliers, provides as follows:

"The DA shall grant exchange rate guarantees, in accordance with the principles set out below, to German equipment manufacturers (suppliers) who deliver for the A320 programme directly or indirectly to the DA or partners in the AI consortium."

(Article 10(2) of the additional Agreement)

"Only that portion of the suppliers' deliveries made in the Federal Republic of Germany (national value added), and in respect of which prices were agreed in US dollars, shall be taken into account for exchange rate guarantees."

(Article 10(2)(b) of the additional Agreement)

"Deliveries within the meaning of letter (b) must have been agreed prior to 1 January 1988 and no price adjustment - other than agreed adjustments for escalation - shall have been made since that date. Where deliveries agreed prior to 1 January 1988 are subsequently made to a different recipient within the Airbus consortium, this shall be non-prejudicial."

(Article 10(2)(d) of the additional Agreement)

Structure and operations of Airbus Industrie

2.6 Airbus Industrie is registered under French law as a "Groupement d'Intérêt Economique" ("G.I.E.") and governed by Ordinance No. 67-821 of 23 September 1967 and Decree No. 68-109 of 2 February 1968. A G.I.E. is a French legal framework which allows its members to carry out collectively certain economic activities while maintaining their separate legal identities, and which does not have as its goal the making of profits. Airbus Industrie has its registered office in Blagnac, France and is comprised of four aerospace companies:

- Aerospatiale Société Nationale Industrielle, a limited company under French law whose registered office is in Paris, France;
- Deutsche Airbus GmbH, a limited liability company whose registered office is in Hamburg, Germany;
- Construcciones Aeronauticas S.A., a limited company under Spanish law whose registered office is in Madrid, Spain; and
- British Aerospace Public Limited Company, a limited liability company whose registered office is in London, England.

2.7 Within the Airbus system, partner companies are involved in all aspects of the business as members, manufacturers and financiers. As members, they take strategic decisions, appoint the directors of Airbus Industrie, approve its general policy and set the administrative and financial rules governing the sharing of risk and profits among the four partners. The sharing of Airbus Industrie's profits and losses among the partners is based on their membership rights. These profits or losses are distributed to the partners in respect of Airbus Industrie's overall activity, and not on a programme-by-programme basis.

2.8 As suppliers, they are committed to deliver to Airbus Industrie specific work packages ("workshares") contracted out to them in dollars under conditions approved by the partners as a whole. Unlike profit participation, the worksharing is defined for each programme. There is de facto a substantial degree of specialization between the partners (British Aerospace is in charge of manufacturing the wings, Deutsche Airbus is responsible for main fuselage sections, Aerospatiale manufactures the cockpit and the central wing box), in order to avoid a costly duplication of heavy industrial investment. While the manufacture of most of the parts of the aircraft is largely carried out directly by the partner companies, a significant proportion of the parts and components for the aircraft is purchased from other suppliers. Amongst the partners and Airbus Industrie and between each individual partner and Airbus Industrie, negotiations take place in respect of each programme, the purpose of which is to define the respective workshares and the transfer price of all aircraft parts and services. The workshare of each of the four partners for an aircraft programme roughly corresponds to the partner's membership rights.

2.9 Airbus Industrie constructs aircraft in the following manner:

- On the basis of planning assumptions which include a given sale price (in US dollars) for the completed aircraft, the four partners decide on the launch of a new aircraft programme.
- They agree among themselves on workshares and on the relative transfer prices, after an elaborate and full assessment of offers from their own companies for parts, components, services, etc. Starting with the A321, tenders from outside companies were also considered for certain sections of the aircraft, additional to the A320 model (from which the A321 is derived). The four partners in turn make their own planning assumptions when they undertake to deliver to Airbus Industrie parts or services for an aircraft programme.

- The subassemblies and components furnished by the four partners are assembled by Aerospatiale in Toulouse (excluding future assembly of the A321 in Hamburg); the aircraft is then flown to Hamburg where cabin fitting is performed and flown back for final reception to Toulouse, which is the point of sale.

2.10 All workshares for the Airbus programmes to which the exchange rate scheme applies, with the exception of the A321 (i.e. the A300, A310, A320, A330 and A340), were decided prior to the entry into force of the scheme. The dates of these decisions coincide with the launch dates for these aircraft programmes and were as follows:

<u>Programme</u>	<u>Launch date/ Workshare decision</u>
A300	1970
A310	1978
A320	1984
A330/340	Spring 1987
A321	2 March 1990

2.11 With regard to transfer prices, these decisions are made in two steps, the first establishing the preliminary transfer price and the second establishing the definitive transfer price. The preliminary transfer price is agreed at the same time as workshare, and is used in the calculation of the expected profitability of a given aircraft programme. The definitive transfer prices are agreed upon after internal negotiation among the partners and between the partners and Airbus Industrie. The dates of these respective decisions were as follows:

<u>Decision</u>		
<u>Programme</u>	<u>Preliminary transfer price</u>	<u>Definitive transfer price</u>
A300	1974 or 1983 (depending on the specific sub-programme of the A300)	before 1985
A310	1982	before 1985
A320	1984	24 November 1989
A330/340	1987	no decision yet taken

Transfer prices for all currently produced aircraft programmes (i.e. excluding the A330/340 which are not yet produced) had been decided prior to the entry into force of the German exchange rate scheme. Workshares - in terms of the partner's responsibility for a certain aspect of the aircraft's production - remained fixed throughout the life of a given programme with the only exception being the existence of a major disruption in production (e.g. a fire in one of the partners' factories). However, there could be subsequent variations in the actual workshare percentage initially agreed, due to the "customization" of the aircraft in the final stage of the production process. Transfer prices remained unchanged in principle, but could be renegotiated, after a long period of time had elapsed, if there had been a fundamental modification of the underlying circumstances. The introduction of the German exchange rate scheme would not constitute a fundamental modification in underlying circumstances. While in the past, the

definitive transfer prices had been very close to the preliminary transfer prices, they could be different, and for the A330 and A340 programmes, the definitive transfer prices remained open. For the A320 programme, the definitive transfer prices were decided after the implementation of the German scheme. The quantities of parts/components to be delivered by the partners is not fixed, due to the fact that the number of aircraft that will be ordered is not known in advance. Each partner takes responsibility for delivering parts/components for a particular aircraft programme over the life of that programme. A price escalation adjustment clause based on an automatic formula is included in the transfer price decisions in order to take account of inflation effects on prices.

2.12 Each partner funds the research and development work in relation to its workshare of an aircraft programme. Airbus Industrie itself has a rôle of planning and co-ordinating the work performed on the aircraft programme by the partner companies and is the sole interface with the client, i.e. the purchaser of the completed aircraft.

2.13 Each partner's workshare is laid down in individual industrial agreements set up between each partner and Airbus Industrie. Under these agreements most supplies are ordered directly by the partners, and each is responsible for buying the equipment and material to be used in manufacturing the parts of the aircraft under its responsibility. For example, Deutsche Airbus is at liberty to subcontract part or all or none of its work to any supplier of its choice. Airbus Industrie is not allowed to order from outside suppliers parts which partners decide to manufacture themselves. Airbus Industrie is responsible for ordering directly from suppliers certain other items which are not included in any partner's workshare (e.g. engines).

2.14 When Airbus Industrie receives delivery of parts/components from the partners, the physical arrival of such parts/components is noted. This act of noting corresponds to the assumption by Airbus Industrie of an "imperfect obligation" for payment. The payment obligation assumed by Airbus Industrie for a fixed amount of money is conditioned on the actual sale of the aircraft incorporating the parts/components furnished by the partner to whom the payment is owed. Ten days following the first payment received by Airbus Industrie for the aircraft, Airbus Industrie has a full unqualified obligation to pay the participating partners. The final settlement between Airbus Industrie and the partners takes place two months after the date of delivery of the sold aircraft, in order to take account of variations in actual workshare percentages due to the "customization" of the aircraft performed at the end of the production process. The payment to each partner is equal to the total of that partner's input to the particular aircraft sold, adjusted upwards or downwards by the amount resulting from the distribution of overall profits and losses, this distribution being based on each partner's respective membership percentage.

Deutsche Airbus's rôle in Airbus Industrie

2.15 Deutsche Airbus is a subsidiary of Messerschmidt-Bölkow-Blohm (MBB); the latter is majority-owned by Deutsche Aerospace, a member of the Daimler Benz group of companies. Deutsche Airbus is a German aerospace company whose sole purpose and function is its participation in the Airbus consortium. As such, it produces fuselages and components for large civil aircraft in connection with Airbus aircraft programmes. Deutsche Airbus's production operations take place solely within German territory. Under the contractual arrangements between Airbus Industrie and Deutsche Airbus existing at the time of the merger, the portion of the material elements of the Airbus programme for which Deutsche Airbus is responsible (subassemblies and components) are shipped to Toulouse, France where assembly of the aircraft from the various elements supplied is performed by Aerospatiale. Such assembly currently takes place exclusively in Toulouse, France for the Airbus programmes to which the exchange rate scheme applies.

2.16 Deutsche Airbus supplies goods and services to Airbus Industrie and to its partners through the Airbus Industrie G.I.E. in accordance with the pre-established workshare. Airbus Industrie takes title - to the extent that it assumes legal liability for any risk involved - to subassemblies and components furnished by the partners when such subassemblies and components leave the respective partners' production facilities en route to Toulouse.

2.17 The partners of the G.I.E. conduct all of their intra-Groupement transactions in US dollars and, in line with general practice on the world market, the completed aircraft are priced in dollars. Deutsche Airbus's production costs are primarily in deutschemarks.

Provision for repayment under the scheme

2.18 The repayment provisions of the scheme vary according to the Airbus programme to which the scheme applies. However, common to all the programmes is the fact that repayment by Deutsche Airbus and by the suppliers covered by the scheme is contingent on the occurrence of specified future events, such as depreciation of the deutschemark and the ensuing exchange rate "gains" for Deutsche Airbus. The scheme establishes no certain time by which repayment must commence, nor any deadline by which repayment must be completed. Amounts disbursed by the Government which have not been repaid by 31 December 2000 will be recovered only in certain circumstances dependent on the DM/dollar exchange rate:

"The FRG shall move to recover Deutschemark accounting profits on US dollar exchange rates (exchange profit) exceeding

- DM 2.00 in the case of the A300, A310 and A320* programmes; and
- DM 1.80 in that of the A330 and A340 programmes."

Footnote: "*For the purposes of this Agreement A320 is the basic version and the A321 (originally the A320-stretched)."

(Article 1(2) of the Agreement)

"Exchange rate profits from the A300/310 programmes from 1 January 1997, the A320 programme from the date of delivery of the 652nd aircraft, but not later than from 1 January 1997, and in the case of the A330/340 programme from the date of delivery of the first aircraft, shall result in claims by the FRG for repayment of amounts due to the FRG and equivalent to the payments it made in previous years under the exchange rate guarantee mechanism. Any further exchange rate profits shall result in claims by the FRG up to the percentages to be offset by the FRG pursuant to paragraph 16(1) in the year in which such profits are achieved. Interest shall be charged in accordance with paragraph 1(2) on payments by DA which are deferred up to 31 December 2000 in order to offset them against future exchange rate losses. In the case of the A320 and A330/340 programmes, however, this provision shall be applied up to 31 December 1996 on a specific programme basis.

"Any claims for recovery by the Federal Republic of Germany outstanding at 31 December 2000 shall become void on this date."

(Article 17 of the Agreement)

However, even after the year 2000, payments by the Federal Republic of Germany under the scheme

"... which have not been offset by exchange rate profits shall be repayable in line with exchange rate movements if recovery claims would have otherwise arisen under the Agreement's rules."

(Article 18(4) of the Agreement)

The Final Provisions section of the Agreement states that

"Facts on which the granting, repayment, claiming, further granting or unaltered retention of the allocation depend shall be taken to be facts relevant to subsidies within the meaning of Paragraph 264 of the StGB. A list of facts relevant to subsidies shall be annexed to this Agreement. In accordance with the provisions of Paragraph 2(2) of the Law on Subsidies, the FRG reserves the right, where necessary, to add further facts relevant to subsidies within the meaning of Paragraph 264 StGB."

(Paragraph 26 of the Agreement)

2.19 The additional Agreement (covering suppliers) contains the following provisions on repayment:

"In return for the exchange rate guarantees granted to suppliers, the DA shall stipulate that repayment be made in accordance with exchange rate movements and by 21 December 2000 at the latest."

(Paragraph 1.(3) of the additional Agreement)

"Any compensation claims by the DA against suppliers still outstanding at the end of the period, after all exchange rate guarantees have been cleared, shall be waived (together with the interest). The sum thus waived shall be deducted from the FRG's recovery claims against DA."

(Paragraph 1.(3)(1) of the additional Agreement)

3. MAIN ARGUMENTS

3.1 Findings sought by the Parties

3.1.1 The United States requested the Panel to find that the exchange risk insurance scheme provided by the German Government to Deutsche Airbus is an export subsidy inconsistent with Article 9 of the Subsidies Agreement, with particular reference to Item (j) of the Illustrative List of Export Subsidies annexed thereto, and to recommend that this subsidy be brought into conformity with the obligations which the EEC has accepted on behalf of Germany under that Agreement.

3.1.2 The EEC requested the Panel to find that the German scheme does not constitute a prohibited export subsidy and does not violate Article 9 of the Subsidies Agreement as interpreted by Item (j) of the Illustrative List, because of the lack of export orientation of the scheme. The EEC further requested the Panel to reject the United States' complaint to the extent that it concerned components delivered by Deutsche Airbus to Airbus Industrie, because the EEC considered that the Panel's terms of reference referred solely to exports of completed aircraft, and therefore the US request to consider components not only was totally irrelevant to the dispute before the Panel, but also constituted an inadmissible change of plea.

3.2 The parties to the dispute disagreed as to the subject matter of the dispute.

3.2.1 The EEC said that the dispute as originally outlined by the United States concerned exclusively trade in large civil aircraft, and not shipments of subassemblies and parts of aircraft. He quoted statements made by the United States in documents circulated prior to the establishment of the Panel as follows:

"The German exchange rate insurance programme provides a significant pricing advantage for Airbus products ..."

(SCM/92)

"... the US hereby requests information on the nature and extent of any subsidies provided to Airbus, including the exchange rate insurance scheme ..."

(SCM/100)

"... the German exchange rate export subsidy alone amounts to an average of approximately US\$2.5 million on each plane delivered by Airbus in 1990."

(SCM/108)

In the EEC's view, the Panel's terms of reference covered only trade in large civil aircraft.

3.2.2 The United States in its reference to consultations with the EEC and in its request for the establishment of a panel, had referred to "an export subsidy of the Government of Germany" (SCM/108, first paragraph). The United States' first written submission to the Panel stated, at page 5,

"The matter before the Panel concerns an export exchange risk insurance programme provided by the Government of the Federal Republic of Germany (the "FRG") to Daimler-Benz AG ("Daimler") as parent of Deutsche Airbus, the FRG partner in the four-nation Airbus Industrie consortium."

The United States then developed arguments, in its first and subsequent submissions, that the purpose of the scheme is to promote exports by Deutsche Airbus of aircraft subassemblies, as well as to promote the Airbus enterprise by virtue of Deutsche Airbus's participation in it.

3.2.3 The United States further said that had the EEC complied with its obligations under Article 7 of the Subsidies Agreement to provide information on the scheme as requested by the United States, the issues before the Panel might have been framed more clearly. The United States asserted that the subject of the dispute was and always had been the exchange risk insurance scheme provided by the Federal Republic of Germany. This scheme constituted a prohibited export subsidy in violation of Article 9 of the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade, with particular reference to Item (j) of the Illustrative List of Export Subsidies annexed thereto, and accordingly, its institution and operation constituted a prima facie violation of the EEC's obligations (on behalf of the Federal Republic of Germany) under the Subsidies Agreement.

Article 9 provided as follows:

- "1. Signatories shall not grant export subsidies on products other than certain primary products.
- "2. The practices listed in points (a) to (l) in the Annex are illustrative of export subsidies."

Item (j) of the Illustrative List of Export Subsidies reads,

"The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases

in the costs of exported products or of exchange risk programmes, at premium rates, which are manifestly inadequate to cover the long-term operating costs and losses of the programmes."

3.3 The parties to the dispute disagreed as to whether or not the scheme was a subsidy.

3.3.1 The United States said that the scheme was an insurance programme without any premium rates and that therefore it met the criterion that premium rates were manifestly inadequate to cover costs and losses within the meaning of Item (j) of the Illustrative List. The German Government had agreed to insure Deutsche Airbus against, and compensate it for, exchange rate losses, and Deutsche Airbus had agreed to make certain payments to the German Government in return. However, the scheme did not require the payment of any amount that would rise to the level of a premium appropriate for a programme of the 12-year duration and breadth of coverage of the scheme. In addition, the costs and losses under the scheme were comprised of at least four elements: (1) administrative costs; (2) payments to cover "losses"; (3) interest, or at a minimum the time value of money advanced to cover "losses"; and (4) the value to Deutsche Airbus of exchange risk insurance. The scheme's repayment provisions were completely silent on the first, third and fourth elements. The United States cited the finding of a 1979 GATT Panel on Export Inflation Insurance Schemes (BISD 26S/330) as follows:

"[A] scheme would not be self-financing, and accordingly could be considered as resulting in an export subsidy, when the total expenditures (operating costs and losses) manifestly exceeded the total income (premiums) over such a period of time and to such an extent that the shortfall could not be covered except by significant and recurrent net capital transfers from the national budget, unless there were a sufficient basis to [expect] that within the foreseeable future the scheme would regain financial equilibrium."

In the United States' view, the scheme met both of the criteria stated in this finding. It was undeniable that the German Government had already had to provide substantial and recurrent net capital transfers, and there was every reason to expect that these transfers would be repeated. For example, regarding so-called "old programmes", defined in the scheme as A300, A310 and certain A320 programme aircraft, during the period 1986-1996 the scheme provided 100 per cent coverage for exchange rate losses between 1.60 and 2.00 DM/dollar based on a yearly average of the DM/dollar exchange rates. In addition, based on the German Government's FY 1992 budget submission to the Bundestag, expenditures for 1991 were anticipated to exceed DM 400 million. A total of DM 4 billion had been provided in the German budget for funding the scheme over its life. There was no provision in the scheme that would provide a "sufficient basis to expect" that any repayment to the German Government would take place during the operation of the scheme, let alone a series of payments sufficient to establish the scheme's financial equilibrium. Any repayment under the scheme was completely contingent on Deutsche Airbus receiving exchange rate "gains" that would result if the DM/dollar exchange rate exceeded a specified level. Further, the provisions in the agreement regarding repayment under the scheme (Articles 17 and 18(4)) appeared to contradict one another and would seem to lead to the conclusion that any repayment "obligations" of Deutsche Airbus and its suppliers after 1 January 2000 were unclear at best. Although the German Government was not required to make any direct payments after the year 2000, it would continue to make indirect payments, in the form of interest foregone, until the last deutschemark was repaid by Deutsche Airbus at some unspecified time in the next century. Thus, the scheme fell far short of the Item (j) standard.

3.3.2 The EEC said that the German scheme clearly did not fall within the category of an insurance policy. The United States had not been able to show the existence of an insurance policy which covered the kind of exchange risks covered by the German scheme. Moreover, if such an insurance policy existed, a premium would not be calculated in the way suggested, as there would be no question of the insured having to repay such a claim with interest, as suggested by the United States. The scheme might be compared with hedging operations offered by certain large financial institutions, such as what

was known as a "cylinder", whereby exchange risk losses were offset by exchange risk gains within certain exchange rate bands. Such operations were self-financing with zero cost (no premium) to the beneficiary. If such schemes were available through the private capital market in some countries, why should a government not have the right to offer a comparable arrangement? Furthermore, Deutsche Airbus did have an obligation to repay, out of exchange rate gains, all amounts paid out by the Government. With regard to the references to the term "subsidy" in paragraph 26 of the agreement between the German Government and Deutsche Airbus, the quotation of this paragraph was potentially misleading, because the use of the term "subsidy" in a provision of German domestic law could have no bearing on the meaning of the same notion under GATT rules.

3.3.3 The United States said that it was unaware of any scheme comparable to the German exchange rate scheme and asked the EEC to provide details on the allegedly self-financing "cylinder". The EEC had provided no explanation as to how a cylinder operates, nor had it addressed the proposition that such a scheme would operate at "zero cost" to the beneficiary.

3.4 The parties to the dispute disagreed as to whether or not the relevant transactions covered by the scheme were exports.

3.4.1 The United States said that Deutsche Airbus, as a supplier to Airbus Industrie, built fuselages for large civil aircraft and exported them to Airbus Industrie for assembly in France by Aerospatiale. The sales of subassemblies by Deutsche Airbus to Airbus Industrie had all the attributes of export sales:

- the transactions occurred on products manufactured by one legal entity in one country (Deutsche Airbus in Germany) and sold to another in a different country (Airbus Industrie in France)
- the supplier shipped product to Airbus Industrie and Airbus Industrie remitted compensation pursuant to a contract.

Deutsche Airbus's shipments to Aerospatiale were exports, notwithstanding that they were intra-EEC. An export occurred when an article of trade or commerce moved from one country to another. The practices of countries - including those that were members of a customs union or free-trade area - reflected this concept. For example, export credit agencies, including those of EEC member States, provided export financing for exports only and not for domestic shipments, i.e. those that remained within the borders of the relevant country. Similarly, the US Export-Import Bank ("Eximbank") considered that shipments from the United States to Canada were "exports" eligible for Eximbank financing, notwithstanding the provisions of the United States-Canada Free Trade Agreement. In addition, there were often "nationality" requirements, relating to the domestic content of the goods to be exported, to qualify for export financing. EEC customs statistics further illustrated that shipments among the member States were tracked as exports and imports. Similarly, each member State reported its exports and imports, which included transactions involving other member States. Cross-border transactions were characterized by the use of export declarations as well as customs transit documents. Moreover, legislation in various member States treated and referred to intra-EEC shipments as "exports" (for example, Section 1 of the United Kingdom's Export of Goods (Control) Order 1989, Customs and Excise 1989 No. 2376). The core US argument had been and remained that the transborder shipments such as those between Deutsche Airbus and Airbus Industrie were universally regarded as exports under EEC law, US law and the laws of EEC member States, as well as under GATT. In addition, the United States pointed out that Airbus Industrie itself admitted the existence of the supplier relationship, thereby refuting the EEC contention that there is some unique aspect of Airbus Industrie's structure that makes these transactions something other than export sales. The United States quoted from a lecture delivered in Cranfield, UK by Jean Pierson, the Chairman of Airbus Industrie, in which

Mr. Pierson characterized Airbus Industrie's four members as having the double rôle of shareholder and supplier and said that as suppliers, they had to deliver to Airbus Industrie specific work packages contracted out to them.

3.4.2 The EEC replied that transfers between Deutsche Airbus and Airbus Industrie were not sales, let alone export sales. There was therefore no "export transaction" between Deutsche Airbus and Airbus Industrie. Airbus Industrie was a single enterprise, a unique example of industrial co-operation between companies in several member States of the European Economic Community. Airbus Industrie was the instrument through which its four members operated. There existed no mere buyer-seller relationship. The supplier, shareholder and financier rôles of each of the partners were aspects of one and the same relationship between Airbus Industrie and its partners. To contend that where goods crossed from one member State to another, trade remained trade - regardless of the level of integration of the member States and regardless of the fact that the industry involved was totally integrated - was nothing more than language, without any foundation in law. Domestic (i.e. member State) legislation had no relevance to this question. The fact that member States themselves treated intra-EEC trade as imports and exports could have no legal consequences; this practice stemmed from purely bureaucratic decisions related to statistical purposes and had no bearing on the EEC's legal obligations. For example, German import/export statistics for 1989 showed the total turnover of the German aerospace industry to be 2.3 billion ECUs, while total aerospace exports were carried at 4.58 billion ECUs.

3.4.3 The EEC further said that to follow the United States' line of argument - that the dispute concerned alleged "exports" of aircraft fuselages from a German firm to a French one and that the provisions of the Subsidies Agreement applied to this factual situation - would constitute a complete innovation in that it would lead to the application of GATT obligations to intra-EEC trade. Even if there were intra-EEC "exports", they would not be subject to the obligations incumbent upon the EEC and Germany under the GATT subsidy disciplines. The Subsidies Agreement had not created obligations between the member States of the EEC. The EEC was the sole signatory of the Subsidies Agreement, and its member States had not contracted inter se as signatories to that Agreement. The nature of the obligation for the member States was the same as that for the EEC as a whole, i.e. not to grant export subsidies on exports to other signatories of the Subsidies Agreement. For these reasons, Germany owed no obligation to France under Article 9 of the Subsidies Agreement, nor to the United States relating to its trade with France.

3.4.4 The United States said that the implication of the EEC's argument regarding Subsidies Agreement obligations was that neither the EEC nor the member States owed an obligation under the Subsidies Agreement to any third party. Such a proposition found no support in the language or interpretative history of that Agreement. For example, Footnote 2 to Item (e) of the Illustrative List contained a declaration by the EEC that certain Irish preferential tax measures related to exports would be phased out. If the EEC's intent had been that such measures did not have to be eliminated under the EEC's and the member States' Subsidies Agreement obligations, there was every reason to expect that the EEC would have so indicated, if only to preserve its "rights" to do so. Similarly, Footnote 37 to Article 18:3 of the Subsidies Agreement explicitly defined the term "governments" in the case of customs unions as meaning governments of all member countries. In the same vein, Footnote 22 to Article 7 provided that the term "subsidies" included subsidies granted by any government or any public body within the territory of a signatory. Nowhere in this language, nor anywhere else in the Subsidies Agreement, was there any suggestion that the obligations of EEC member States would not be owed to other EEC member States, or, for that matter, to third parties. More fundamentally, the Subsidies Agreement explicitly provided in Article 8:4(c) that adverse effects or serious prejudice might arise through "the effects of the subsidized exports in displacing the exports of like products of another signatory from a third country market". The Statement of Administrative Action that accompanied the United States Trade Agreements Act of 1979 (which implemented the Subsidies Agreement) stated that "[a]cceptance by the European Community of an agreement ... shall be treated as acceptance by

both the Community and each member State." Nowhere in the record of this legislation was there any suggestion whatever that the obligations of the EEC member States would not be owed to each other. A derogation from the Subsidies Agreement of that magnitude would have been made explicit had it been intended. The EEC's theory, if accepted, would result in the creation of a zone of immunity for all EEC member States from the export disciplines of the Subsidies Agreement. This would occur for the following reasons: in almost every instance, an export subsidy granted by an EEC member State would benefit exports, a substantial percentage of which would be destined for other EEC member States. In such circumstances, the EEC would argue, first, that these intra-EEC sales were not "exports" within the meaning of the Agreement; and second, that the existence of a substantial percentage of such "domestic" sales benefiting from the subsidy would mean that the subsidy was not "export-oriented" and that therefore, even the application of that subsidy to sales to customers outside the Community would not be a prohibited export subsidy. Such a result would eviscerate the export subsidy disciplines in the Subsidies Agreement, and was totally unsupported by the negotiating history of the Agreement. Moreover, not only would this grant to EEC member States a favoured treatment compared with other Subsidies Agreement or GATT signatories, it would also open up the possibility that other customs unions now organized or being organized around the world would take this decision as a sign that export subsidies for trade within the customs union would be free from the Subsidies Agreement export subsidy disciplines. The Subsidies Agreement contained no suggestion of any such exclusion for customs unions in general or the EEC in particular. In fact, to permit members of customs unions to grant export subsidies in this manner would establish barriers to trade of other contracting parties with such territories in a manner explicitly proscribed by Article XXIV:4 of the GATT. The EEC's interpretation of its obligations under Article 9 of the Subsidies Agreement would mean that the signatories to the Agreement accepted a substantial reduction in export subsidies obligations on the part of EEC member States compared to the obligations accepted by all the EEC-9 member States (except Ireland) under Article XVI:4 of the GATT.¹ It was hard to believe that other countries - including the United States - would have acquiesced in such an interpretation at the time the Subsidies Agreement was concluded, without any discussion or indication of what the United States or other non-EEC parties received in exchange for this major concession. Furthermore, the EEC itself did not appear to have had such an interpretation of EEC member States' obligations under Article 9 at the time the Agreement was signed. Had the EEC had such an interpretation at that time, it would certainly not have issued the declaration in Footnote 2 of the Illustrative List to the effect that Irish export-related preferential tax measures would be withdrawn in conformity with Article 9, since under the EEC's current interpretation, much of the effect of the Irish tax measures would have been on intra-EEC "domestic" trade rather than on exports. Moreover, since the 1960 Declaration remained in force, the EEC interpretation of Article 9 would mean that the EEC member States who are signatories to the Declaration have much less freedom to use export subsidies than those EEC member States that are not party to the Declaration. This was a highly impractical result, and one for which there appeared to be no support in the negotiating history leading up to the conclusion of the Subsidies Agreement. In addition, the United States submitted that the EEC position made no economic sense. There was clearly international competition for sales made between EEC member States, precisely the type of competition that was supposed to be free of export subsidy distortion. In the view of the United States, the EEC's argument was particularly inappropriate when applied to a subsidy granted by the German Government rather than the EEC as a whole. The United States went on to say that it was well settled as a matter of law that cases against member State subsidy practices were against the individual member State maintaining the practice, not against the entire EEC. The Panel reports on Income Tax Practices Maintained by France (BISD 23S/114), Belgium (BISD 23S/127), and the Netherlands (BISD 23S/137), respectively, substantiated this point.

¹Article XVI:4 was given effect by the 1960 Declaration Giving Effect to the Provisions of Article XVI:4 of the Agreement of 30 October 1947.

3.4.5 The EEC said that contracting parties had implicitly recognized that the EEC shouldered the obligations of the member States under the Subsidies Agreement. The member States were bound, in logic and in law, by the same obligations as the EEC. The EEC was only bound under Article 9 not to grant subsidies on exports to third parties; thus, the member States were bound by exactly the same obligation, i.e. not to grant subsidies on exports to non-EEC countries. Regarding the references by the United States to footnotes to the Subsidies Agreement, Footnote 22 to Article 7, if applied to the EEC, meant that the governments and public bodies of the member States, next to the institutions of the EEC, could be regarded as organs granting subsidies within the meaning of the Subsidies Agreement. This confirmed the fact that the member States and their governments were bound by the Subsidies Agreement disciplines through the EEC, but it said nothing about the scope or nature of the member States' obligations under that Agreement. Footnote 37 to Article 18:3 confirmed the unity of the EEC as a party to the Subsidies Agreement, as it excluded the participation as a panel member - in a dispute settlement panel - of an individual from any member State should the EEC be involved in the dispute. Footnote 39 to Article 19:4 was a simple convenience which had allowed the drafters to avoid making a separate mention of the EEC in the text of the Agreement and which confirmed that the EEC and its institutions were bound by the Subsidies Agreement. The paragraph of Footnote 2 to Item (e) of the Illustrative List referred to by the United States did not have any bearing on the kind of obligations that member States had under the Subsidies Agreement, as the Irish preferential tax measures were illegal under both GATT and EEC law. Regarding Article 8:4(c), the term "third country market" would mean a non-EEC country market, based on the logical implications flowing from the EEC's participation as a signatory to the Subsidies Agreement. This was not just a matter of the EEC's own interpretation of the level of integration the EEC had reached, but something which had been recognized by the other parties contracting with the EEC and in the practice of the GATT, by recognizing the EEC as a de facto or even de jure successor to the obligations and rights of its member States in the field of trade, and especially in the field of subsidies.

3.4.6 The EEC went on to say that the alleged "precedents" which the United States had cited regarding income tax practices maintained by France, Belgium and the Netherlands were not only 15 years old and predated the signing of the Subsidies Agreement, but did not deal explicitly, or even implicitly, with the question raised here; at no time did they address the question of a distinction to be made between a taxation of companies from other member States and from third countries, based on the obligations incumbent on the EEC. Furthermore, by accepting the EEC as sole signatory of the Subsidies Agreement, which fully applied and interpreted the provisions of Articles VI, XVI and XXIII of the General Agreement, the other contracting parties, including the United States, had accepted that the EEC was the entity responsible for full application and interpretation of these GATT Articles.

3.4.7 The United States replied that, at least for the present, the level of integration of the EEC had not reached the point where imports and exports had ceased to exist as such, and the EEC had offered no substantiation of its arguments to the contrary. National boundaries still counted for something, and most instruments of, at least, fiscal and monetary policy operated according to national laws. If import and export statistics were meaningless, as the EEC had suggested, why were they kept? The G.I.E. legal status of Airbus Industrie did not exempt its partner countries from normal import/export transactions with each other, and there was no indication whatever that shipments among partners in a G.I.E. were treated differently for the purpose of member State or EEC customs statistics. Regarding the GATT legal obligations of the EEC and of the member States, virtually all of the member States at the time the Subsidies Agreement had been signed already had obligations under Article XVI:4 of the General Agreement. Was the EEC now saying that when the EEC signed the Subsidies Agreement, the member States backed away from their obligations under Article XVI? Further, the EEC's interpretation flew in the face of Article XXIV:4 which stated clearly that,

"... the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories."

The EEC's interpretation of the member States' Subsidies Agreement obligations was incongruous in that, for example, Spain and Portugal, prior to signing the Treaty of Rome, could have had different obligations regarding subsidies vis-à-vis other member States after signing the EEC treaty.

3.5 The United States claimed that the scheme was an export subsidy.

3.5.1 The United States said that the German scheme was designed as a support for Deutsche Airbus's exports of subassemblies to Airbus Industrie and that it operated directly on the export transaction between Deutsche Airbus and Airbus Industrie. Regardless of whether Airbus Industrie was viewed as a foreign purchaser or simply as a conduit, the fact remained that it was Deutsche Airbus's supply of German-produced components and subassemblies for which Deutsche Airbus was subsidized under the scheme. The subsidy was paid directly on the export transaction between Deutsche Airbus and Airbus Industrie or, in the alternative, the subsidy was paid on the supply of German components for incorporation into an aircraft sold to a foreign purchaser. Thus the subsidy operated directly also on export sales of completed aircraft, because it was the share of the aircraft purchase price allocated to Deutsche Airbus that was guaranteed against exchange rate risk. There had been, and were, no domestic sales covered by the scheme, i.e. no sales within Germany of either subassemblies or completed aircraft. Consequently, every transaction covered by the scheme to date was an export transaction.

3.5.2 The EEC replied that the scheme was not export oriented for the following reasons: trade in large civil aircraft was conducted entirely in US dollars, whatever the final destination of the aircraft and whatever the national currency of seller and buyer; the German scheme covered exchange losses on Deutsche Airbus's share of the revenue stream in US dollars arising from the sale (including on the domestic market) of completed Airbus aircraft; since Airbus Industrie was a consortium of four partners located in four member States of the EEC, and since there was no other independent manufacturer of large civil aircraft in the EEC, its domestic market was the EEC; the scheme did not in any way discriminate between export and domestic sales, either in respect of eligibility for, or extent of, the coverage. The scheme applied to Deutsche Airbus's activities at double arm's length: (a) it was contingent upon sales of Airbus aircraft, not on the individual transfer of parts; and (b) the transfer of parts was totally divorced from the operation of the scheme and could not be encouraged or discouraged by the existence of the scheme. Contrary to what had been suggested by the United States, there was a total lack of causal relationship between exports and the German scheme. Prior to the signing of the scheme in December 1988, the Airbus Industrie partners had already fixed, for all Airbus programmes (except the A321) and for the remainder of the economic life of those programmes, what the workshare to each partner would be, and the precise modalities of all future deliveries. These decisions thus predated the entry into force of the exchange rate scheme. No production or sales decision by Deutsche Airbus would be affected by this scheme. Furthermore, the scheme would apply in exactly the same way to the A321 programme for which assembly would take place in Hamburg, Germany. In summary, the United States' line of argument would lead to the absurd result that all aircraft subsidies within the EEC were export subsidies and that there was no relevant domestic market. Item (j) of the Illustrative List could not be invoked on the basis of nomen juris and where there was no discrimination in favour of export sales. It could only be invoked against a practice that met the requirements of Article 9 of the Subsidies Agreement, and a practice which was not export oriented could not meet such requirements. In any event, the dispute under examination concerned trade in aircraft, and in this respect the United States had failed to demonstrate that the scheme was export oriented. Regarding the United States' contention that the subsidy operated directly also on export sales of completed aircraft, this was factually incorrect and should be rejected for this and two additional reasons: (1) even if it were accepted that there was a subsidy on parts of an aircraft,

the United States would have to demonstrate that there was an upstream subsidy on finished aircraft; and (2) the subsidized product and the finished product allegedly affected by the subsidy were not "like" products.

3.5.3 The United States recalled its earlier argument regarding intra-EEC exports and that the "G.I.E." legal status of Airbus Industrie did not exempt the partner countries from normal import/export transactions with each other. Furthermore, there was neither a factual nor a legal basis for the EEC argument that the domestic market was the 12 member States of the EEC. There had been and were to date no "domestic" sales covered by the scheme, and should the German Government decide to expand the scheme's coverage to include, for example, the A321 programme which involved assembly in Hamburg, and should such aircraft assembled in Hamburg be purchased by a German airline, this domestic transaction would not insulate the scheme from challenge as an export subsidy. To permit inclusion of some domestic sales in order to defeat a programme's characterization as an export subsidy would be wholly without support in either the language or the rationale of Item (j), would fail to protect the integrity of the provision and would eviscerate the export subsidy disciplines of the Subsidies Agreement. The dollar denomination of large commercial aircraft sales did not excuse the scheme as a non-prohibited export subsidy. There was no requirement that aircraft be traded in dollars, and it was by no means universally "customary" to buy and sell aircraft components in dollars; Airbus Industrie's "internal" transactions could have been priced in any currency. The EEC argument that the scheme, if it were to be considered a subsidy, could only be prohibited if it were "export oriented" would impose a new requirement not contained in the language of the Subsidies Agreement. There was no reference in the Illustrative List to the requirement that the exchange rate scheme operate on an "export-oriented" transaction. Contrary to the position of the EEC, the United States contended that there was no requirement in this export subsidy case that adverse effects be demonstrated. However, the United States also contended that the German exchange rate scheme in fact caused adverse effects on both international - and specifically US - trade, both with respect to trade in aircraft components and sub-assemblies and as to trade in aircraft. The subsidy, by its nature, had direct effects on international competitiveness, as exchange rates were the fundamental force in international trade that equilibrated international competition. The effect of the subsidy was to enable Deutsche Airbus to offer or accept a lower price, because it did not have to bear the risk of adverse exchange rate fluctuations. With respect to trade in aircraft components and sub-assemblies, the US contended that the exchange rate scheme has had and will have adverse effects on international trade in at least the following respects:

- (1) It enabled and will enable Deutsche Airbus to offer a lower price in all initial workshare agreements concluded after the terms of the exchange rate scheme were finalized in the early fall of 1989. This includes the initial workshare agreements for the A320, A321, A330, A340 and all subsequent programmes;
- (2) It enabled and will enable Deutsche Airbus to offer a lower price on design modifications that may be agreed to on all Airbus programmes. including those whose initial workshares were concluded before the terms of the exchange rate scheme were finalized;
- (3) It increases Deutsche Airbus's ability to continue, without price renegotiation, its participation in a programme even where adverse exchange rate fluctuations occur which, absent the scheme, would reduce or eliminate Deutsche Airbus's profit; and
- (4) It discourages Deutsche Airbus from subcontracting to a non-German subcontractor because only deutschemark expenses are protected under the scheme.

With regard to trade in aircraft, the scheme has a direct effect on Deutsche Airbus's participation in all decisions with respect to the pricing of Airbus aircraft, because it is the portion of the aircraft selling

price received by Deutsche Airbus which is protected against adverse exchange rate fluctuations. The subsidy operates directly on the exports of aircraft (as well as sub-assemblies) by its application directly to the dollars received for that portion of the aircraft sale attributable to the Deutsche Airbus workshare. This means that, in any agreement among Airbus member companies on the pricing of aircraft, Deutsche Airbus will be able to advocate or accept a lower aircraft price or a greater discount from the "list" or "sticker" price than would be possible if its share of that price were not protected against exchange rate fluctuations. Specifically, this means that the exchange rate scheme has affected and will affect the initial decision by the Airbus partners on the "list" or "sticker" price for an aircraft programme where that decision was made after the date on which Deutsche Airbus knew that it would be protected by this scheme against exchange rate risk. In the view of the United States, this effect was felt in the setting of the "sticker" prices for the A321, A330 and A340 and would be felt in all subsequent programmes. In addition, Airbus Industrie had to consult with the member companies, including Deutsche Airbus, before offering a substantial discount off the aeroplane's "list" or "sticker" price. This was acknowledged in 1988 by Airbus Industrie's Chairman:

"When Frank Shrontz (Boeing's Chairman) shaves one million dollars off his price to win a deal, he knows exactly what he's doing. When we want to do that, we have to ask permission." (Financial Times, 8 July 1988)

This means that each Airbus Industrie decision to offer a reduced price is affected by the German exchange rate scheme, because that scheme enables Deutsche Airbus to advocate or agree to a price lower than would otherwise be possible. Thus, in addition to the effect the scheme has on Deutsche Airbus pricing as a supplier to Airbus Industrie, the scheme also has an impact on Airbus Industrie pricing of aircraft. Regarding the EEC's description of how the scheme operated and on what factors it was contingent, the United States took the position that the scheme was a subsidy on the exportation from Germany of subassemblies, despite the fact that the payment by Airbus Industrie to Deutsche Airbus for those subassemblies was not made until the sale of the aircraft, with the consequent payment to each of the Airbus member companies of the portion of the purchase price allocable to that company's workshare. Despite the delayed payment, the amount received by Deutsche Airbus from Airbus Industrie was explicitly acknowledged to be payment for the Deutsche Airbus subassemblies. Therefore, as a matter of law, this payment -- whether or not delayed and whether or not contingent on sale of the aircraft -- was the compensation paid to Deutsche Airbus for its export of the subassemblies from Germany. Thus, this payment -- the payment that was insured against exchange rate risk by the German scheme -- was the payment for an export sale. And this was true whether the sale was construed as an export of subassemblies from Deutsche Airbus to Airbus Industrie or as an export of subassemblies by Deutsche Airbus through Airbus Industrie to the purchaser of the aircraft.

3.5.4 The EEC considered that the remarks made by the United States concerning the pricing of aircraft or components in a currency other than the US dollar simply did not reflect commercial reality. The world market for large civil aircraft was dominated by US manufacturers. Airbus had no choice but to price its aircraft in US dollars in order to remain in business. This meant in turn that transfer prices for manufacturing activities of the partner companies had to be in dollars. The aircraft sector was the only example of an industrialized, manufactured product which was traded on the domestic European market in a non-European currency.

4. SUBMISSION BY THIRD PARTY

4.1 Brazil made a submission to the Panel as a third party, which included the following points. EMBRAER (Empresa Brasileira de Aeronáutica S.A.), a Brazilian manufacturer of commuter aircraft, was unique in the international civil aircraft market in that it received no development or production subsidies. The financing conditions offered by competitors could, although legitimate, have severe adverse effects on the terms of competition of competitors not benefiting from such conditions. Thus,

it was crucial that all indirect support currently being granted to manufacturers in this sector be monitored so as to avoid unfair and even predatory competition. At a time when developing countries were unilaterally taking steps to deregulate their economies, it was all the more necessary for the strengthening of the multilateral trading system that the developed countries refrain from attempting to gain unfair advantages in world markets through the use of subsidies. In this regard, the monitoring function of the Subsidies Committee should be reinforced. It was a matter of concern that the EEC had not provided information as requested by the United States under Article 7 of the Subsidies Agreement, and the Committee should be informed of any public support given by the EEC relevant to the Panel's terms of reference. Brazil reserved its rights under Article 18:7 of the Agreement to be given complete information should a mutually satisfactory solution to this dispute be reached by the parties. Lastly, the Panel, in carrying out its mandate, should take into consideration the interests of developing countries under Article 14:9 of the Agreement.

5. FINDINGS

5.1 The Panel first considered its terms of reference. The EEC argued that these permitted the Panel to deal only with issues raised by the United States concerning trade in large civil aircraft, not aircraft components, since the latter had not been mentioned in the original description of the dispute by the United States. The United States disagreed. The Panel noted that the United States, in its request for the establishment of a panel (SCM/108), focused on the German exchange rate scheme as such and did not specifically exclude any product included in the scheme. Accordingly, the Panel considered that the matter referred to the Committee by the United States was formulated in such a way that it did not limit the scope of the Panel's enquiry to aircraft.

5.2 The Panel noted that the issue before it was whether the German exchange rate guarantee scheme was inconsistent with the prohibition in Article 9 of exchange risk programmes as set out in Item (j) of the Illustrative List of Export Subsidies. The Panel considered that in light of the rules of treaty interpretation, it had to interpret Item (j) of the Illustrative List in accordance with the ordinary meaning to be given to the terms of Item (j) and of Article 9 of the Subsidies Agreement in their context and in the light of their object and purpose. The Panel started its examination with the ordinary meaning of the terms of Item (j). The Panel noted that Item (j) of the Illustrative List covers "the provision by governments ... of exchange risk programmes, at premium rates, which are manifestly inadequate to cover the long-term operating costs and losses of the programmes". The Panel considered that this language clearly sets out two conditions: (1) the measure in question must be covered by the term "exchange risk programme"; and (2) any premium rates must be manifestly inadequate to cover the long-term operating costs and losses of the programme. Regarding the term "exchange risk programme", the Panel noted that Footnote 5 to Item (j) uses the term "contracts" in referring to "programmes" in the context of the evaluation of the long-term adequacy of premium rates, costs and losses. The Panel considered that any scheme which, through a contract or an agreement between the government and a company, directly or indirectly attenuated or compensated for the effects of exchange rate movements¹ would be covered by the term "exchange risk programme" and that therefore this term included exchange rate guarantee schemes. Regarding the condition, "at premium rates, which are

¹The Panel noted that in the Working Party examining export inflation schemes, several members, including the EEC, had expressed the view that exchange rate guarantees constituted a means of protecting an exporter's competitiveness which was precisely analogous to the export inflation insurance schemes already examined. This view was not contested by other members of the Working Party who, however, considered that the terms of reference of the Working Party were strictly limited to export inflation insurance schemes (BISD 24S, page 119, paragraph 10).

manifestly inadequate to cover the long-term operating costs and losses of the programmes", the Panel considered that in assessing an exchange risk programme, what counted was not the particular premium rate applied to a particular transaction, but whether the scheme was set up in such a way that the total of all premiums would be likely to cover the total of all costs and losses under the programme. The Panel thus considered that Item (j) was applicable to any exchange risk programme which involved a net cost to the government. A programme that did not contain premium rates and which was set up in such a way that its long-term operating costs and losses have to be borne, in total or in part, by the government would therefore fall under the provision of Item (j).¹

5.3 The Panel then examined whether the German exchange rate guarantee scheme was designed in such a way as to cover the long-term operating costs and losses of the programme. The Panel noted three features of the scheme: first, no interest accrued in favour of the German Government on money paid by it to Deutsche Airbus, between the time of disbursement and the date at which an eventual repayment became due; therefore, under no circumstances would this interest be paid. Second, the scheme did not provide for any recovery of administrative costs - an element in operating costs - which in all cases were borne by the German Government. Third, the Panel noted that any repayment to the German Government of the funds disbursed was contingent on a rise in the dollar/deutschemark exchange rate above a certain level. Unless this happened, a net benefit accrued to Deutsche Airbus in the form of interest-free funds which did not have to be repaid. The Panel noted the argument that the existence of a subsidy resulting from possible non-repayment of the funds disbursed depended on unforeseeable future developments. However, it considered that the conditional nature of the obligation to repay constituted an element of subsidy in the scheme. The Panel therefore concluded that there were long-term operating costs and losses of the German exchange rate guarantee scheme which manifestly were not covered by its repayment mechanism.

5.4 The Panel then proceeded to examine the context in which the terms of Item (j) had to be applied. Item (j) was drafted in the context of the prohibition of export subsidies in Article 9 of the Subsidies Agreement and constituted an element in the Illustrative List which interpreted the term "any form of subsidy on the export of any product" (Article XVI:4). The Panel therefore considered that a further question to be examined in the determination of whether the scheme was covered by Item (j) was whether it was granted on exports. The Panel noted that the scheme was set up so as to apply to all payments made by Airbus Industrie to Deutsche Airbus for the total of Deutsche Airbus's input to the aircraft in question. The Panel then examined whether the deliveries of these inputs were export transactions.

5.5 The Panel considered that it was first necessary to clarify under what conditions a good was considered to be exported within the meaning of the Subsidies Agreement. The Panel noted that while the term "export" had not been specifically defined in the General Agreement, Articles of the General Agreement used this term in the sense of a good moving from the territory of one contracting party to the territory of another contracting party. In defining the scope of most-favoured-nation treatment, Article I:1 compares treatment extended to "any product ... destined for any other country" with "the like product ... destined for the territories of all other contracting parties" (emphasis added). Likewise, Article XI covers restrictions "on the exportation or sale for export of any product destined for the territory of any other contracting party" (emphasis added). A similar conclusion could be drawn from

¹The Panel noted, in this respect, that in previous discussions in GATT concerning consistency or inconsistency with Article XVI:4, i.e. in the Working Party examining export inflation insurance schemes, there was no disagreement (although some members of the Working Party considered that the measure under examination was per se a subsidy in contravention of Article XVI:4) that the first test to determine this consistency or inconsistency was whether or not the scheme was a subsidy, and not the technical modalities of the scheme (BISD 24S, pages 125-126, paragraphs 27-29).

the analysis of other Articles of the General Agreement, e.g. Articles III and XIII. Thus, the use of this term in the General Agreement indicates that a good was exported if it moved from the territory of one contracting party to the territory of another contracting party. The Panel then proceeded to examine whether this criterion had been met in the case of the movement of goods from Germany to France.

5.6 The Panel turned first to the text of the Subsidies Agreement. Article 9 refers only to the term "export", and does not specify what might be the relevant border for export subsidy purposes. However, Article 9 was an interpretation of Article XVI:4. Article XVI:4 applied to Germany as a contracting party. The Panel therefore considered that the German national boundary was a relevant border for the purposes of determining an export subsidy under Article XVI of the General Agreement. Since the signatories of the Subsidies Agreement intended to "apply fully and interpret" the General Agreement, they could not have intended to modify the concept of relevant border, which was a key element in the determination of export subsidies. Additionally, a major purpose of the Tokyo Round was to tighten disciplines on non-tariff measures. The Panel therefore considered that it could not have been the intention nor was it the legal right of the signatories of the Subsidies Agreement to authorize export subsidies which were prohibited under the General Agreement. In the absence of any clear indication in the Subsidies Agreement, the Panel could not assume, where a customs union but not its constituent member states had signed the Agreement, that national borders within the customs union were not relevant for the purpose of determining the existence of an export subsidy. The member States of the EEC were today still GATT contracting parties, and GATT obligations, in particular that of Article XVI:4, still applied individually to them. The Panel further noted that it would be inconsistent for the export subsidy disciplines of the Subsidies Agreement not to apply to the exports of an EEC member State, because export subsidy practices engaged in by an EEC member State had an impact on third (non-EEC) country signatories which were suppliers of the product benefiting from such subsidies. In addition, the Panel noted that EEC trade statistics carried transactions among EEC member States as exports and imports. Similarly, the criteria used by the Governments of Germany and France to provide export credit in their respective countries considered trade between Germany and France as foreign trade.

5.7 The Panel considered the EEC argument that the intertwined legal relationship of Airbus Industrie with its partners meant that the transfer of components between Deutsche Airbus and Airbus Industrie did not constitute an export from Germany to France. The Panel noted that, in accordance with the use in the General Agreement of the term "export", even transfers effected within one single company or corporate entity, the production facilities (or similar elements) of which were located in different countries, would be considered to be exports if such transfers moved from the territory of one contracting party to the territory of another contracting party. The Panel therefore considered that the nature of relations among and between partners of a G.I.E. which were located in different countries was not relevant in determining whether or not a transaction was an export.

5.8 Thus, the Panel found that all inputs delivered by Deutsche Airbus to Airbus Industrie were, at the time when the scheme was established as well as at present, exported from Germany to France. The scheme therefore applied to payments for transfers of inputs, which transfers were found to be exports only. The Panel also noted that the scheme applied only to transfers between Deutsche Airbus and Airbus Industrie. The function of the scheme was to underpin transfers of components to a particular receiver and not to encourage production of these components in general. In this respect the scheme differed from a situation in which, for example, a government covers operating losses of a company whose production happens to be totally exported, or gives a regional subsidy which benefits a company that happens to export only. In these cases, the respective companies would benefit from the subsidy regardless of whether they continued to sell for export only or also sold the product to domestic buyers. In the case before the Panel, Deutsche Airbus, if it wanted to benefit from the scheme, had no choice but to conduct its transactions with a particular company which at this time was located in the territory

of another contracting party, i.e. it had to export. The Panel therefore concluded that the scheme was granted on exports. It also noted that as the scheme applied only to transactions between Deutsche Airbus and Airbus Industrie, it was contingent on transfers which were found to be exports only.

5.9 The Panel noted the EEC argument that in future, the assembly operations for the A321 aircraft programme will take place in Hamburg, Germany, and that the scheme will then also apply to the transfers to that particular destination. The Panel considered, however, that the question of the possible future disbursement of funds under the scheme for a programme other than those programmes for which funds had been and were being actually disbursed was not an issue which was relevant to the Panel's examination of the scheme. First, the Subsidies Agreement interprets Article XVI of the General Agreement. Under Article XVI:4 the basic test to determine a subsidy to be prohibited is the comparison between the domestic price and the export price of the subsidized product. It is evident that such a comparison can only be made using the same or very close period of time. Although the dual price criterion is not an element in Item (j), it is only appropriate that the analysis of the application of this item has to be made in terms of present conditions and not future developments. Second, the scheme at present is available only for particular sales to a particular destination. Again, the key question in the analysis of the nature of the scheme is what would happen if, at present, domestic buyers (and not one particular buyer) wanted to buy the product in question. The answer is that Deutsche Airbus would not benefit from the scheme for any such transaction. In other words, the scheme is available only for transactions which are exports. Third, the concept that the consistency of a measure has to be determined not only in the light of its present, but also a possible future application would open a dangerous loophole in the export subsidy disciplines. The implication of such an approach is that a subsidy on exports would be a prohibited export subsidy only if the government explicitly excluded the possibility that such a subsidy may apply, in future, to particular domestic sales; for example, the provision by a government of subsidies to a firm contingent on exports would fail to meet the contingency test if the government made the subsidy available also for future sales to a particular company if and when this company establishes a subsidiary or production facilities in the territory of the exporter. To accept that such a future-oriented and limited to a single buyer provision in a subsidy programme would determine the present legality of the programme would be an open invitation to attach such or similar clauses to any export subsidy, thus removing it from the prohibition under Article 9 of the Agreement.

5.10 The Panel noted the argument raised by the EEC that a measure covered prima facie by Item (j) has to be examined further with a view to determining whether it is "export-oriented". In the EEC's view, the German scheme included particular characteristics which warranted such an examination. These were as follows: (1) the scheme was established in order to facilitate the takeover by a private company (Daimler Benz) of the German Airbus partner (Deutsche Airbus); (2) Airbus Industrie conducts all its trade in US dollars, whatever the destination of the product supplied by the Airbus partners; (3) when, in future, the assembly operations for the A321 aircraft programme take place in Hamburg, Germany, the scheme will apply also to domestic sales. The Panel considered that these elements were not relevant to its analysis of the scheme. Article 9:1 of the Subsidies Agreement contained a prohibition of "export subsidies" and Article 9:2 provided, without qualification, that the measures and practices in the Illustrative List were illustrative, i.e. examples, of "export subsidies".¹ The purpose of Item (j) was therefore to give an example of a measure which was prohibited under Article 9 of the Subsidies Agreement. The Panel was of the view that where a practice could be established to be a subsidy "on the export of any product", there was no support in the wording of Article 9 for the proposition that an additional criterion - that is, whether that practice was "export-oriented" - should be taken into

¹In this relation, the Panel noted that it was explicitly agreed with respect to the 1960 list of export subsidies on which the Illustrative List of the Subsidies Agreement was based, that the measures on that list were considered as subsidies in the sense of Article XVI:4 (BISD 9S, pages 186-187, paragraph 5).

consideration for the purpose of determining whether that practice was covered by the Illustrative List. Furthermore, any such test would imply the existence of an agreed definition of export subsidy or of agreed exhaustive criteria which would determine a measure to be an export subsidy. Not only did such agreed definition or criteria not exist, but the drafters of the Agreement made a clear choice not to use any generic definition or criteria but to set forth the coverage in Article 9 by providing a list of measures and practices which were examples of export subsidies.¹ There was therefore no agreed legal basis in the text of Article 9 or in the Illustrative List itself which would allow the Panel to examine any item on the List in the light of the "export orientation" criterion. As to implicit criteria underlying some other items of the Illustrative List, the Panel noted that if a measure was not specifically covered by Items (a) through (k) of the Illustrative List, then it had to be examined in the light of Item (l) and not in the light of other criteria which could be derived from other items in the Illustrative List. In this relation the Panel noted that Item (l) of the Illustrative List did not refer to any such criteria but that it specifically referred to Article XVI:4 which prohibited "any form of subsidy on the export of any product other than a primary product which subsidy results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market".

5.11 The Panel also noted that the Illustrative List treated in a different way measures where the economic basis for such a different treatment had not been demonstrated. An example was the treatment of direct and indirect taxes in the Illustrative List, or of inputs physically incorporated in a product or only used in the production process but not physically incorporated. This spoke in favour of the conclusion that the drafters of the Subsidies Agreement had preferred a formal approach, and thus legal security, over any effects- or intention-test. The Panel therefore concluded that the existing legal framework and recognition of the principle that it should not propose a generic definition - where such a definition had been proposed and clearly had not been agreed to in the negotiations leading up to the existing Subsidies Agreement - did not allow the Panel to go beyond the plain language of that Agreement. The Panel therefore concluded that it could not judge a measure found to be covered by the Illustrative List in the light of the criterion of "export orientation".

5.12 The Panel then considered the application of the German scheme to aircraft. The Panel noted that the scheme applied to payments for Deutsche Airbus's inputs to Airbus Industrie and not to sales of the aircraft by Airbus Industrie. The Panel noted that the sales of the aircraft triggered the payments to Deutsche Airbus; however, the Panel considered that the question of what triggered the payments from the final producer to the supplier was not, in itself, relevant for the determination of the nature of the subsidy in question. Because of the operation of the scheme, inputs from Deutsche Airbus could be offered to Airbus Industrie at a lower price, but these inputs were used by Airbus Industrie for the production of aircraft irrespective of their destination. Therefore, the scheme constituted, for the purpose of the production of the aircraft by Airbus Industrie, a subsidy which reduced the cost of production of the aircraft thus making its price more competitive for all foreign and domestic buyers. Such a subsidy was not an export subsidy in the sense of Article XVI of the General Agreement and was not, therefore, covered by Item (j) or any other item of the Illustrative List. The Panel, therefore, considered that it was not necessary to examine further in its analysis the transactions involving deliveries of aircraft by Airbus Industrie.

¹The Panel noted that during the Tokyo Round Negotiations at least two attempts were made to agree on a definition of export subsidy. In an informal text dated 5 November 1976 the drafters of the text proposed that an export subsidy was "...any benefit, conveyed directly or indirectly, ... the benefit being related to the degree or extent of export performance, or otherwise involving differential treatment or benefit in favour of products sold for export over like products sold domestically ...". In an early draft of the present Subsidies Agreement it was proposed that an export subsidy was any charge on the public account ... which is conveyed directly or indirectly upon an exported product and which results in differential treatment, including price, covering products sold for export over like or directly competitive products sold domestically" (MTN.NTM/W/210, page 13).

6. CONCLUSION

6.1 In light of its findings and reasoning in paragraphs 5.2, 5.3 and 5.8 above, the Panel concluded that the German exchange rate guarantee scheme resulted in a subsidy granted on exports and that the scheme was prohibited in terms of Article 9, as an export subsidy covered by Item (j) of the Illustrative List.

6.2 The Panel recommends that the Committee on Subsidies and Countervailing Measures request that the exchange rate guarantee scheme operated by the Government of Germany with respect to Deutsche Airbus be brought into conformity with the provisions of Article 9 of the Subsidies Agreement.