

GENERAL AGREEMENT ON

TARIFFS AND TRADE

RESTRICTED

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Sub-Committee of the Committee
on Trade in Civil Aircraft

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ELEMENTS OF THE FRAMEWORK FOR NEGOTIATIONS

Communication from Canada

The following communication, dated 29 January 1993, has been received from the Permanent Mission of Canada.

The following views on the GATT Agreement on Trade in Civil Aircraft (the Agreement) discussions are offered by Canada pursuant to our commitment under Article 8.3 of that Agreement. It will be recalled that Article 8.3 commits Signatories to "undertake further negotiations, with a view to broadening and improving this Agreement on the basis of mutual reciprocity". The views offered in this paper are intended to assist the Aircraft Sub-Committee in addressing the issues to be considered in such negotiations.

INTRODUCTION

The Agreement, negotiated within the context of the Tokyo Round, contains rights and obligations specific to the civil aircraft sector of Signatories. These rights and obligations are grounded on the general rules of the GATT. However, the Agreement builds upon the rules, disciplines and procedures of the GATT in two important and distinct ways:

- the Agreement clarifies and elaborates general GATT rules so that they are relevant to, and particularly effective for, the civil aircraft sector. An example would be Article 4.3 which identifies exact criteria to be considered regarding the purchase by Signatories, of products covered by the Agreement.
- the Agreement contains new or more stringent disciplines which go beyond the general GATT rules. Examples include (a) elimination of tariffs on all products covered, (b) extension of provisions of the 1979 Agreement on the Technical Barriers to Trade to aircraft certification requirements and specifications on operation and maintenance procedures and (c) disciplines on government-directed procurement.

The motivation behind the Agreement, as stated in its preamble, was "to achieve maximum freedom of world trade in civil aircraft, parts and related equipment, including elimination of duties, and to the fullest extent possible, the reduction or elimination of trade restricting or distorting effects."

While the full realization of this objective may not yet have been achieved by Signatories, the Agreement nevertheless stands out as the only sectoral free trade agreement which seeks to go beyond the normal multilateral rules and disciplines of the GATT.

Two major events lead us to the conclusion that it is particularly opportune to conduct these negotiations. First, the Uruguay Round negotiations hold the potential for unprecedented improvements in the general GATT rules in a number of areas specifically referred to in the current Agreement (e.g. Article 3 re: Technical Barriers to Trade; Article 6 re: Subsidies and Article 8 re: Dispute Settlement). In addition, the Uruguay Round results will include, for the first time, a framework of principles and rules governing trade in services, together with commitments to liberalize such trade. The 1979 Agreement should be revisited in the light of these advances in the general rules of the GATT and the establishment of the GATS.

Second, the United States and the European Community negotiated in July 1992, a bilateral agreement for large civil aircraft (LCA). While the focus of this agreement was to respond to a particular problem concerning a subset of products covered by the current Agreement and involving two signatories and three individual companies, it contains several provisions disciplining government assistance to the large civil aircraft sector. Despite its narrow focus, some of the provisions of this Agreement may be incorporated into a new set of general multilateral rules for the entire civil aircraft sector.

CANADIAN APPROACH

In the renegotiation of the 1979 Aircraft Agreement, the Committee should keep in mind the two distinct ways in which the current Agreement builds upon the general GATT rules, i.e. (a) the clarification and elaboration of the general rules and (b) the development of additional, more strict disciplines than those which apply generally.

First and foremost, all generally applicable GATT rules and provisions, as improved in the Uruguay Round, should apply to products covered by the Aircraft Agreement.

In addition, the following elaborations and additional disciplines should also be incorporated into a revised Aircraft Agreement.

Coverage

The Sub-Committee should explore the expansion of the current product coverage to include additional products related specifically to the civil

aircraft sector. For example, Canada has proposed the inclusion of "aircraft fasteners" which are classified under the HS 7318.15.80, 7508.00.50 and 8108.90.3060.

The Sub-Committee may also wish to explore the feasibility of building on the obligations and commitments of the Air Services Annex of the GATS.

Customs duties and other charges

The new Agreement should continue to require the elimination of all customs duties and other charges on covered products.

Technical Barriers to Trade

The reference in the 1979 Agreement should be updated to refer to the Agreement on Technical Barriers to Trade contained in the Uruguay Round Text. Two additional provisions should also be included:

1. The provisions of the Uruguay Round Agreement on Technical Barriers to Trade (TBT Agreement) would also apply to government procurement of covered products, i.e. the exemption for government procurement in paragraph 1.4 of the TBT Agreement would not apply to covered products.
2. The provisions of the TBT Agreement would also apply to the certification, maintenance and repair of covered products. The application of the terms of the TBT Agreement to other services relating to the civil aircraft sector should be explored by the Sub-Committee.

Procurement

For the purposes of this agreement, procurement should include all acquisitions through either purchase or long-term lease.

(a) Government Procurement

The provisions of the Uruguay Round Agreement on Government Procurement should be examined with a view to their application to all covered products.

(b) Government-Directed Procurement

The provisions of Annex I of the US-EC Agreement on Large Civil Aircraft should be incorporated into the new Aircraft Agreement as they are a considerable improvement to Article 4 in the current Agreement.

(c) Civil - Military Designation

Canada suggests that a revised Aircraft Agreement should make clear that its provisions apply to all purchases of covered products. To this end, the Sub-Committee may wish to examine the definition of "civil aircraft" as contained in Article 1.2 of the current Agreement.

Subsidies

The Uruguay Round text is the first international trade agreement to contain a detailed definition of "subsidy". This definition is based on the concept of a financial contribution by a government which confers a benefit to the recipient. The UR text makes clear those forms of government intervention that constitute a subsidy e.g., grants, loans, loan guarantees. Government provision of goods and services (other than general infrastructure) and government purchase of goods are also included in this definition. The UR text also contains clear criteria for defining "actionable", "non-actionable" and "prohibited" subsidies. In addition, the UR text contains significant improvements to the rules addressing serious prejudice, as well as strengthened disciplines on the ability to use countervailing measures.

In Canada's view, a revised Aircraft Agreement should take account of and incorporate the improved subsidy-based disciplines developed in the Uruguay Round. In addition, the Committee should consider three elaborations of these general provisions:

(a) Definition of research

The UR Subsidies text exempts civil aircraft from the non-actionable category of research subsidies on the basis that a separate multilateral agreement would address this issue for civil aircraft (see Article 8.2(a), footnote 1 of the UR Subsidies text). Careful consideration should be given to developing definitions of applied and basic research which are appropriate to the aircraft sector. Although the definition of "development" in the EC-US agreement goes well beyond the intended scope of either "applied" or "basic" research, it nevertheless provides a basis upon which such definitions could be developed. Canada is preparing a specific proposal for the definition of "applied research" in Article 8.2(a) tailored to the particular realities of the civil aircraft sector.

(b) Calculation of a subsidy in terms of the benefit to the recipient:

Article 14 of the UR Subsidies text specifies for the first time in a multilateral trade agreement parameters for the methodology used in the calculation of the amount of subsidy as well as a commitment to transparency in the application of such parameters.

Canada agrees with those who point out that the particular complexities surrounding the subsidies provided by governments to the civil aircraft sector through either equity infusions, loans and loan guarantees or the provision or purchase of goods and services may require further elaboration in a new Aircraft Agreement. For example, the Sub-Committee may wish to explore how further precision could be provided in the case of government assistance to the civil aircraft sector in the case of equity infusion (e.g. in assessing sector-specific risk provisions) or with respect to government loans (e.g. in determining the interest rate of a "comparable commercial loan which the firm could actually obtain on the market").

In addition, further precision in the methodology for calculating subsidies may be desirable in the case of government purchases or the provision of services.

(c) Calculation of total 'ad valorem' subsidization for the purposes of Article 6.1(a) of the UR Subsidies Text

Annex IV of the UR Subsidies text is the first attempt within the GATT to provide precision to the calculation of subsidies for the purposes of determining whether 'serious prejudice' exists. Canada regards Article 6 of the UR Subsidies text, and its methodological parameters as articulated in Annex IV, to be a significant achievement of the Uruguay Round. Nevertheless, the unique features of government assistance to the civil aircraft sector (e.g. long-term loans, relatively high risks and a royalty-based payment schedule) may call for further precision in a new Aircraft Agreement.

As regards disciplines which are more stringent than the general GATT rules, the Sub-Committee may wish to consider extending, for the covered products, the category of "prohibited subsidies" contained in the UR Subsidies text to include subsidies contingent upon production. The Sub-Committee may wish to consider whether the inclusion of such a provision in a new Aircraft Agreement would be subject to the Transitional Arrangements (i.e. three years) already provided for in the UR Subsidies text (Article 28). It is Canada's view that, apart from this provision aimed at transitional arrangements for existing subsidies which would be "prohibited" in a new Agreement, there should be no "grandfathering" of prior government commitments from the disciplines of either the Uruguay Round Subsidies text or a revised Aircraft Agreement.

Temporary derogations

It is Canada's view that no temporary derogations should be permitted from either the disciplines of the general rules of the GATT as improved in the Uruguay Round or the disciplines of a new Aircraft Agreement.

Dispute settlement

There should be maximum integration of the dispute settlement provisions of this Agreement with the general provisions of the Dispute Settlement Understanding, i.e. the Dispute Settlement Understanding should apply to the fullest extent possible. Should the new Agreement remain an Annex 4 Uruguay Round Agreement, this Sub-Committee will need to address such questions as:

- participation of non-signatories in disputes concerning the provisions of this Agreement (e.g. non-member participation in Panels);
- participation of non-signatories in the approval process of Panel reports with respect to disputes concerning the provisions of this Agreement;

- cross-retaliation between any new Aircraft Agreement and other agreements.

Special and differential treatment

While the current Agreement on Trade in Civil Aircraft is an Annex 4 Agreement within the context of the Uruguay Round, it is Canada's objective to see any new Aircraft Agreement apply to all Contracting Parties. Failing this, the new Agreement should endeavour to secure the widest possible membership amongst Contracting Parties. With this objective in mind, the new Agreement should contain provisions aimed at Special and Differential Treatment for developing country Signatories as well as for Signatories in the process of transformation from a centrally-planned to a market-oriented economy.

SUPPORT-BASED DISCIPLINES ON GOVERNMENT FINANCIAL ASSISTANCE

It has been suggested that the disciplines on "government support" contained in the EC-US Agreement on Large Civil Aircraft (LCA) could serve as a basis for developing additional multilateral disciplines on government financial assistance to the civil aircraft industry. The views of delegations differ over whether such disciplines on "government support" should be in addition to, or a substitute for, the general rules and disciplines on subsidies of the GATT.

Canada does not support having such rules replace the normal rules of the GATT, as improved in the Uruguay Round. However, some have suggested that disciplines on "government support" based on those contained in the EC-US Agreement on LCA should be considered as potential additional disciplines to normal GATT rules. Canada wishes to provide the following comments on the appropriateness of "support-based" disciplines in a multilateral agreement based on GATT principles and rules.

(a) Direct support

A central concept in the EC-US Agreement on LCA is that of "government support" of which there are two broad types: (1) direct; and (2) indirect. While there is no basic definition of "support", direct support would appear to include any financial flow (e.g. grants, loans, loan guarantees) from government and its agencies to a firm in the civil aircraft sector. There are two key exceptions however. First, equity infusions of any nature, or under any conditions, are not included. Secondly, official export credit financing consistent with the provisions of the OECD's Large Aircraft Sector Understanding are similarly exempt from any additional disciplines.

Direct support is then divided into two categories: production support and development support. The boundary between development and production is the date of certification of the aircraft. Production support, that is, any support granted after the date of certification, is prohibited. Development support is also prohibited unless it conforms to

specific criteria articulated in Article 4 of the EC-US Agreement (e.g. loan not to exceed 33 per cent of specified costs; repayable at specified interest rates over seventeen years according to a prescribed royalty schedule).

In assessing the concept of direct support, it is useful to recall some critical facets of the concept of "actionable subsidy" as contained in the UR Subsidy text. First, a subsidy exists if there is a financial contribution by government which confers a benefit to the recipient, that is to say, the mere fact that funds have been received from government does not mean that a subsidy exists unless a benefit has been conferred (e.g. an interest-free loan). Second, "actionable subsidies" require a distortion of trade causing injury, serious prejudice or nullification or impairment to be established prior to disciplines being imposed. Both these key aspects of "subsidy" are absent from the concept of "direct support" in the EC-US Agreement.

As a result, the EC-US Agreement prohibits actions which would not be "actionable subsidies" in the sense that these actions neither confer a benefit nor injuriously distort trade e.g. a generally available loan guarantee/low interest loan programme or a research subsidy otherwise deemed to be "non-actionable" under the general provisions of Article 8:2(a) of the Uruguay Round Subsidies text. On the other hand, it exempts from its provisions actions which could very well both confer a benefit and injuriously distort trade (e.g. equity infusions).

By focusing on the financial contribution of government action, the Uruguay Round Subsidies text ensures that the same discipline will apply to a dollar of injurious trade distorting subsidy whether it is in the form of equity, a grant, a low interest loan, a loan guarantee, the provision of goods and services or the purchase of goods. The concept of "direct support" is not capable of imposing such equal disciplines on all such forms of government assistance and as such would not be an appropriate discipline to adopt in a multilateral GATT-based agreement.

(b) Indirect support

Indirect support is any financial support provided by government or its agencies for research, development and demonstration projects other than those directly related to a civil aircraft programme. Two distinct cases come to mind: (1) funds provided to a firm or institution other than the firm producing the particular large civil aircraft; and (2) funds provided to the firm producing the particular large civil aircraft for other programmes of that firm not directly related to the development/production of large civil aircraft (e.g. military aircraft). In addition, to be considered indirect support, such funds received must result in "identifiable benefits" such as "identifiable reduction in costs of large civil aircraft".

Given the difficulty in identifying and measuring such "benefits" or "reduction in costs", it has been suggested that a proxy be used. The proxy suggested is the amount of government funds spent on those research, development and demonstration projects which have resulted in "commercially applicable results" which are not made equally available to all manufacturers of LCA.

Government funds spent on such projects must not exceed, in any year, either 3 per cent of annual "commercial turnover" of the domestic LCA industry or 4 per cent of the annual "commercial turnover" of LCA of any one firm.

There are several problems with using the concept of indirect support when establishing disciplines on government assistance to research and development.

First, while Article 8:2 of the UR Subsidies text grants "non-actionable" status to government assistance to certain research activities, there is a cap to such non-actionable assistance (i.e. 25 per cent for applied research; 50 per cent for basic research). In the case of indirect support, governments can fund the entire research programme.

Second, the concept of "injurious trade distortion" is absent from indirect support.

Third, neither the government granting the funds nor the firm receiving them knows whether government financing of a particular project is prohibited or not until several years after the initial disbursement of funds, i.e. when it has been confirmed that "commercially applicable results" have been achieved that "commercially applicable results" have been achieved. Similarly, other countries would not be able to challenge government funding of a particular project until these results were known.

Finally, since all research and development need not achieve "commercially applicable results", actual government R&D subsidies would typically exceed, say, 4 per cent of a firm's annual turnover. For example, assuming a success rate of 33 per cent, it would appear that government could finance a total of 12 per cent of the annual turnover of a firm under the provisions of the EC-US Agreement on LCA. This compares with the normal GATT rule of a 1 per cent de minimus level as regards countervail actions.

For the above reasons, Canada would prefer to develop appropriate rules regarding government financing of research and development for covered products based on the concept of subsidy. Specifically, footnotes (1) and (3) to Article 8:2(a) of the UR Subsidies text call for the establishment of rules governing non-actionable research subsidies for the civil aircraft sector as well as a review of the definition of "applied research".

In addition, it should be noted that Article 14(d) of the UR Subsidies text provides guidelines on the measurement of benefits received in cases where governments provide goods or services or purchase goods. The Sub-Committee may wish to elaborate these guidelines in addressing disciplines on indirect support.

CONCLUSION

In conclusion, it is Canada's position that the general rules of the GATT, as improved in the Uruguay Round, apply to all of the products covered in the Aircraft Agreement. In addition, Canada supports the initiative to strengthen and improve the provisions of this Agreement. Canada's approach to this exercise, one which we hope is shared by other contracting parties, is to use this opportunity to build upon the progress made in the Uruguay Round negotiations with a view to establishing new and more stringent disciplines on government involvement in this sector.

In this regard, Canada appreciates the contribution made by the EC and the US in the negotiation of their bilateral agreement on large civil aircraft. The broad objective of this bilateral agreement is to reduce trade distorting effects resulting from government support to the development, production, and marketing of large civil aircraft. This objective, one which Canada fully supports, is consistent with the objectives of the GATT Aircraft Agreement. Moreover, despite its narrow scope there may be provisions in the EC-US Agreement that could form the basis for provisions in a broadly-based multilateral agreement, particularly with regard to government-directed procurement. However, other concepts in this agreement e.g. "support", cannot in our view, provide balanced and effective disciplines in a multilateral context. In Canada's view, such improvements are best achieved through building upon the provisions of the Uruguay Round Subsidies text.