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GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-253697

June 9, 1993



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The Honorable Richard Gephardt
Majority Leader
House of Representatives

Dear Mr. Gephardt:

This letter responds to your request that we review, and assess the implementation of, the bilateral agreement between the United States and the European Community (EC) concerning trade in civil aircraft. As you know, the agreement was intended to promote a more favorable environment for international trade in large civil aircraft by eliminating production supports for future programs and limiting development and indirect supports for such programs.

As agreed with you, in an effort to keep you informed of significant findings in a timely manner, this letter describes our concerns about provisions of the agreement dealing with prior commitments of EC member governments to provide support for current programs. In a later report, we plan to assess (1) the agreement and its relationship to other international agreements concerned with trade in the civil aircraft industry, (2) the monitoring and implementation of the agreement, (3) efforts to make the agreement multilateral, and (4) the implications of the agreement for the competitiveness of the U.S. aircraft industry.

BACKGROUND

After more than 5 years of sometimes intense negotiations, on July 17, 1992, the United States and the European Community signed the "Agreement Concerning Application of the GATT [General Agreement on Tariffs and Trade] Agreement to Trade in Civil Aircraft." The U.S. civil aircraft industry has generally supported this agreement, with a common industry view that it is a useful first step in eliminating government support for production of large civil aircraft.

GAO/GGD-93-41R U.S.-EC Aircraft Agreement

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The agreement was primarily concerned with eliminating production supports for future programs and limiting development supports and indirect benefits for such programs. Article 2 of the agreement noted that "government support to current large civil aircraft programs, committed prior to the date of entry into force of this Agreement, is not subject to the provisions of this Agreement except as otherwise provided below." However, that article also noted that the "terms and conditions on which such support is granted shall not be modified in such a manner as to render it more favorable to the recipients; however, de minimis modifications shall not be deemed inconsistent with this provision."

Article 8.2 of the agreement, dealing with transparency, stated that "with regard to prior government commitments for large civil aircraft programs provided for in Article 2, a complete list of such commitments by the Parties to this Agreement already disbursed or committed shall be separately provided, including information on the type of repayment obligation and the planned period of repayment. Annual disbursements and repayments relating to these programs on an aggregate basis shall also be notified to the other Party for each government providing these supports. In addition, a Party shall notify the other Party to this Agreement of any changes which render the terms and conditions of such support commitments more favorable to the recipient, including: changes in the repayment period; failure to repay the support; or reduction of the scheduled repayments."

TERMS AND CONDITIONS OF PRIOR SUPPORT TO AIRBUS UNKNOWN

On July 16, 1992, the EC gave the United States a list of prior commitments of development and production support by member governments of the EC (France, Germany, the United Kingdom, and Spain) to their respective Airbus consortium members (Aerospatiale, Deutsche Airbus, British Aerospace, and Construcciones Aeronauticas S.A. [CASA]). While the list did contain, by country, the amount of commitment per Airbus program, the type of repayment, and the repayment period, the list did not contain key terms and conditions of such support. For example, with the exception of one country, the list contained no interest rates. Nor did the list contain the amount of royalty payment per aircraft program per country. Also, while the EC provided schedules containing the amount of disbursements and repayments per country per year, those amounts were not disaggregated by aircraft program.

Not having this information limits the U.S. ability to monitor, implement, and enforce the agreement. It is

difficult to see how the United States will be able to assess EC compliance with the agreement without knowing key terms and conditions of prior government support. Such terms and conditions constitute a baseline against which to judge whether they have been changed in a manner that would make support more favorable to the recipients.

An official of the U.S. Trade Representative (USTR) said that, under Article 8.2, the EC was not obligated to provide the United States with the terms and conditions of past supports. He noted that USTR negotiators had, over the years when the agreement was being negotiated, actively sought the inclusion of a requirement to provide such information. However, the EC did not agree to this inclusion. The EC argued that providing such information would reveal Airbus' cost and price structure, which is highly sensitive commercial information. The EC further argued that U.S. manufacturers would resist providing such information.

We questioned whether the United States would be able to determine whether the EC was in compliance with Article 2 of the agreement if the United States did not have more specific information on the original terms and conditions on which support for current programs was granted. The USTR official said that while the situation was not ideal, it was USTR's experience that USTR, in monitoring the agreement in cooperation with other agencies, including the Department of Commerce, would be able to determine whether there were any major changes to the terms and conditions. He further indicated that while USTR and Commerce officials might be unable to monitor precisely disbursements and repayments with respect to current programs, they would likely learn of any major changes in terms and conditions through other sources. He also stated that industry efforts to secure an easing of terms and conditions were usually the subject of protracted discussion with governments and much speculation in commercial circles. In the view of USTR, it would be difficult to modify terms and conditions so as to make them more favorable to the recipients without attracting public and/or parliamentary scrutiny. He also indicated that the consultative provisions of the agreement, as well as Article 8.6 (which requires parties to furnish additional information relevant to the implementation of the agreement), would enable the United States to follow up in any instance in which there was a reason to suspect a violation. In addition, he provided us with a document from the EC, dated March 1993, which stated generally that, in accordance with Article 2 of the bilateral agreement, the terms and conditions on

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which support by EC member governments to Airbus had been granted had not been modified in such a manner as to render it more favorable to the recipients.

We recognize that there was considerable EC opposition to having to disclose the terms and conditions of prior government support. At the same time, however, there are significant problems associated with the nondisclosure of such terms. First, the U.S. government will not have a firm baseline against which it can verify that the EC has adhered to the agreement. Without this baseline, the U.S. government must rely on other sources of data that may not be accurate or available for use during negotiations rather than data that the EC could have provided. Second, should there be a dispute about whether terms and conditions were changed, not having a disclosed list of terms and conditions would complicate the task of resolving the dispute.

THE CASE OF DEUTSCHE AIRBUS

The importance of the disclosure of terms and conditions is demonstrated with respect to German government support to Deutsche Airbus, the German member of the Airbus consortium. In 1989, in response to its concern about the cost of support to Deutsche Airbus, the German government sold Messerschmitt-Boelkow-Blohm (MBB), the German state-owned company of which Deutsche Airbus was a subsidiary, to Daimler-Benz.¹ As part of the terms, the German government made several major concessions to Daimler-Benz, including a guarantee against losses on export sales resulting from exchange rate changes. The United States viewed the arrangement as an explicit violation of general GATT restrictions on export subsidies. After the United States filed a formal complaint against the German exchange rate guarantee, a GATT panel ruled in favor of the United States in early 1992. Although the EC has never accepted this panel report, the German government decided to eliminate the exchange rate scheme.

¹Background information concerning the case of German government support to Deutsche Airbus is discussed in some detail in Laura D'Andrea Tyson, Who's Bashing Whom? Trade Conflict in High-Technology Industries, Institute for International Economics (Washington, D.C.: Nov. 1992), and in Airbus Industrie: An Economic and Trade Perspective, Congressional Research Service (Washington, D.C.: Feb. 20, 1992).

Just before the signing of the bilateral agreement, a top USTR official wrote to the German government in order to clarify USTR's understanding of the arrangements being made to compensate Daimler-Benz for the elimination of the exchange rate scheme. He indicated USTR's understanding that Daimler-Benz would still be obligated to repay funds already disbursed under the exchange rate guarantee programs in accordance with the terms of the 1989 agreement. The USTR official also indicated USTR's understanding that Deutsche Airbus was obligated to continue to repay all government supports provided by the German government in accordance with the terms and conditions previously agreed upon. Finally, he noted that USTR considered the transfer of the German government's 20-percent equity stake in Deutsche Airbus to Daimler-Benz to be a prior government commitment within the meaning of Article 2 of the bilateral agreement.

On April 15, 1993, at the International Trade Commission hearing on the competitiveness of the U.S. aerospace industry, an Airbus official agreed with the statement that there has been a virtual suspension of repayments to the German government. He went on to say: "There is a clear understanding that due to the special conditions surrounding privatization of Deutsche Airbus, there has been some relaxation of the repayment schedule in this country."

A USTR official indicated that he initially believed the repayment relaxation reflected the long-standing "weakness" of repayment terms that characterized the relationship between Deutsche Airbus and the German government. However, he said there also appeared to be some modification of repayment terms prior to the signing of the bilateral agreement as part of the renegotiations with Daimler-Benz. Given this, USTR is now seeking to ascertain the significance of those changes.

The limited ability of the U.S. government to verify precisely whether or to what extent Deutsche Airbus' repayment terms permit relaxation of its repayment schedule raises concerns about the usefulness of the transparency provisions of the bilateral agreement in monitoring EC member government subsidies to Airbus consortium members. The absence from the information exchanged of the actual terms and conditions of Deutsche Airbus' repayment requirements makes it more difficult to determine if the repayment relaxation that the Airbus official referred to is consistent with those terms. Any modification of the terms of support in place when the bilateral agreement was

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signed that render the support more favorable to Deutsche Airbus could be inconsistent with the agreement.

CONCLUSION

Nondisclosure of terms and conditions associated with prior government support for Airbus programs greatly complicates the task of ensuring that the U.S.-EC agreement, in its implementation, attains its goal of reducing government support for the manufacture of civil aircraft. The issues surrounding the repayments of Deutsche Airbus to the German government exemplify how this task has been complicated.

Assessing the implications of nondisclosure for the agreement's value inherently involves difficult policy tradeoffs. On the one hand, the U.S. civil aircraft industry, while aware of the agreement's limitations, does generally support the agreement as a useful first step. Thus, it may be appropriate to regard the agreement as an improvement over the prior situation and view the nondisclosure issue as a price to be paid for the improvement. Alternatively, since nondisclosure limits U.S. ability to monitor, implement, and enforce the agreement, it may be appropriate for the United States to strive to strengthen substantially the transparency provision; this strengthening could occur during negotiations to include additional nations in this agreement.

AGENCY COMMENTS

We sought comments on this letter from USTR and the Department of Commerce. Commerce officials declined to comment, deferring to USTR. USTR officials agreed with the overall conclusion of this letter and provided language that clarified their position on their ability to monitor the agreement and the relationship between the German government's elimination of the exchange rate guarantee and the concessions to Daimler-Benz.

As you requested, we plan no further distribution of this report until 30 days after its issue date. At that time, we will send copies to the U.S. Trade Representative, the Secretary of Commerce, and other interested parties. Copies will also be made available to others on request.

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Please contact me on (202) 512-4812 if you or your staff have any questions concerning this letter. The information in this letter was developed by James McDermott, Assistant Director; Stanton Rothouse, Evaluator-in-Charge; Thomas Melito, Senior Economist; Sheila Ratzenberger, Assistant General Counsel; Richard Perruso, Attorney; and Gretchen Bornhop, Senior Evaluator.

Sincerely yours,

A handwritten signature in black ink, reading "Allan I. Mendelowitz". The signature is written in a cursive style with a large initial "A".

Allan I. Mendelowitz, Director
International Trade, Finance, and
Competitiveness

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