1995

The Aircraft Subsidies Dispute in the GATT's Uruguay Round

Shane Spradlin

Follow this and additional works at: https://scholar.smu.edu/jalc

Recommended Citation
https://scholar.smu.edu/jalc/vol60/iss4/7
THE AIRCRAFT SUBSIDIES DISPUTE IN THE GATT'S URUGUAY ROUND

SHANE SPRADLIN*

TABLE OF CONTENTS

I. INTRODUCTION ........................................... 1192
II. THE ORIGINAL GATT TREATY AND THE TOKYO ROUND ......................... 1194
III. TWO DIFFERENT TRADE PARADIGMS .......... 1197
IV. THE URUGUAY ROUND ................................ 1201
   A. THE AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES ........... 1201
   B. THE FIGHT OVER AIRCRAFT SUBSIDIES .......... 1205
      1. The German Exchange Rate Case ................. 1207
      2. The 1992 Civil Aircraft Agreement .......... 1208
      3. The Aircraft Industry and the Subsidies Negotiations ............... 1210
      4. The Agreement Not To Agree ............ 1212
      5. The Next Time .................................... 1214
V. CONCLUSIONS ............................................. 1216

* J.D., U.C.L.A. School of Law, 1995; B.A., Brown University, 1992. This comment was written while the author was a third year law student at U.C.L.A. School of Law. The author would like to thank Phillip Trimble for his inspiration for this article as well as Carol Spradlin, Joe Spradlin, Joe Schuble, and Alexandra Parnass for their encouragement and support.

1191
I. INTRODUCTION

"There is no such thing as a level playing field."1

SEVEN YEARS ago, when the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) commenced, all involved parties committed to agree on rules limiting government subsidies to industry. First proposed in 1945, similar attempts in the past achieved only limited success.2 Even agreement on the most fundamental issue, the definition of a subsidy, was unresolved. The problem was that, taken to the extreme, almost any government expenditure, such as one for education or road building, may be interpreted as a subsidy. Direct payments to industry obviously qualified, but that was the extent of the consensus. Whether unemployment programs, job training, and disaster assistance qualify as subsidies remains undecided.

Subsidies have proved to be hard to limit in part because they are so effective. Governments use them "to promote important objectives of national policy,"3 such as stimulating infant industries, supporting ailing industries, promoting exports, creating jobs, and in certain sectors, increasing national security and national prestige.4 A related problem is that subsidies involve sensitive governmental action only curable through high level diplomatic negotiation.

Furthermore, subsidies are easily legislated because they directly benefit certain groups, while their harm is spread over all of society. The beneficiaries are readily apparent while those hurt do not have a large enough stake in the matter to lobby against them. Also, recipients are usually politically popular and sympathetic groups, like farmers,

---

3 Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade, Apr. 12, 1979, Preamble, reprinted in GATT, BASIC INSTRUMENTS AND SELECTED DOCUMENTS 56 (Supp. 26 1980) [hereinafter Subsidies Code].
4 See McDonough, supra note 2, at 810.
who provoke little opposition. In short, the elimination or reduction of subsidies requires international commitment because "the concentrated interests of producers command greater [national] political support than the diffuse interests of consumers,"\(^5\) which results in a classic tragedy of the commons. There is also usually less opposition than one might expect in importing countries who benefit from cheaper goods as a result of these subsidies, as long as no monopolistic intent is attributed to the subsidizing country.\(^6\)

At times, it seems that subsidies benefit everyone. One must, however, remember the original mission of the GATT: to increase world prosperity.\(^7\) These subsidies allow countries without a comparative advantage to produce certain products, undermining world prosperity. In short, subsidization yields inefficiency, at least according to the GATT paradigm.

In no industry has the subsidies question been more contentious than in aircraft manufacturing. The traditional American prominence in the field has been shattered by the European Community's Airbus consortium. The United States and the European Community have been unable to resolve the dispute, though they have been negotiating for over twenty years. Recently, this one industry almost thwarted the seven years' work of the Uruguay Round. Furthermore, in response to this dispute, the U.S. aircraft manufacturing industry has called for Congress to accept a new "industrial policy" which would promote direct government involvement in industry.\(^8\)

This paper traces the evolution of the GATT subsidies rules beginning with Article XVI of the original GATT and the 1979 Subsidies Code. Part II focuses on the American

\(^5\) Id.
\(^7\) Id. at 7-15.
\(^8\) Trade and Competitiveness of U.S. Industry: Hearings Before the Senate Comm. on Finance, 102d Cong., 2d Sess. 56-59 (1992) (testimony of Lawrence Clarkson, Vice President for Planning and International Developments, The Boeing Corp.).
and European conception of "industrial policy," which has largely shaped these rules, and examines the recent pressure in the United States to accept industrial policy, in part due to the influence of the aircraft manufacturing industry. Part III focuses on the recently completed Uruguay Round and uses the aircraft manufacturing industry's ultimate exclusion from any final agreement to exhibit the difficulty of resolving the subsidies issue. Finally, Part IV considers the effects of excluding an industry from the GATT process and attempts to reconcile industrial policy with the goals of subsidy limitations. Throughout this analysis, the paper focuses on the bargaining positions of the United States and the European Community, the major players in the aircraft subsidies negotiations. This is not meant as a slight to the other countries involved in GATT negotiations, but is simply a practical reflection of bargaining power.

II. THE ORIGINAL GATT TREATY AND THE TOKYO ROUND

By requiring parties to report them, the original GATT treaty, signed in 1947, acknowledged that subsidies may adversely affect international trade.9 Article XVI contained a one paragraph obligation requiring countries merely to "notify the CONTRACTING PARTIES in writing of the extent and nature of [their] subsidization," its estimated effect, and, if serious prejudice were likely to occur, to discuss the subsidies with other concerned parties.10

In 1955, additional obligations were added to Article XVI.11 The result was that the GATT differentiated between export subsidies, aids to promote foreign sales, and domestic subsidies, which benefit an industry without regard to where its product is sold.12 Export subsidies were forbidden on primary products, defined generally as fish,

10 GATT, supra note 9, art. XVI(1).
11 See Jackson et al., supra note 6, at 768-69.
farm, or forest products, if the subsidy permitted the country to obtain "more than an equitable share of world export trade in that product."\textsuperscript{13} For non-primary products, defined as everything else, parties agreed to "cease to grant either directly or indirectly any form of subsidy" on their exports if the result was a lower price in foreign markets than in the domestic market.\textsuperscript{14} This effectively forbade bi-level pricing on non-primary products.\textsuperscript{15} If these obligations were violated, Article VI of the GATT authorized countries to impose countervailing duties.\textsuperscript{16} This remedy has an equally complex history which is outside the scope of this paper. Basically, if a subsidy obligation was violated, a government was allowed to impose a tariff on that good in an amount proportional to the subsidy, though each country has entertained evolving additional rules and requirements on these tariffs.

Because the original GATT was so effective in reducing direct tariffs, the Tokyo Round, which lasted from 1973 until 1979, focused on the reduction of subsidies and other nontariff barriers.\textsuperscript{17} Conversely, at that time, governments were under increasing pressure to grant subsidies, especially to industries ailing from the worldwide recession. Therefore, the United States and the European Community agreed that the aim of the resulting 1979 Subsidies Code was not to eliminate the subsidies themselves, a drastic result, but to "reduce or eliminate [their] trade-restricting or distorting effects."\textsuperscript{18}

As negotiation proceeded, it became clear that the United States looked to this round to have subsidization, but the European Community countered that "stringent international regulation of domestic subsidies would amount

\textsuperscript{13} GATT, supra note 9, art. XVI(3).
\textsuperscript{14} Id. art. XVI(4).
\textsuperscript{15} The distinction between primary and non-primary goods in these additional obligations caused their rejection by developing countries, so that most GATT nations did not recognize them. Jackson et al., supra note 6, at 728.
\textsuperscript{16} Id. at 769.
\textsuperscript{17} McDonough, supra note 2, at 816.
\textsuperscript{18} Subsidies Code, supra note 3, at Preamble.
to intolerable interference in their internal policy matters.” Nonetheless, the European Community was willing to bargain because it wanted to soften the U.S. policy of imposing countervailing duties against foreign industries even when the opposing U.S. industry was not “materially injured” by the subsidies.20

The two sides compromised by using different rules for domestic and export subsidies.21 Export subsidies were absolutely forbidden for non-primary products,22 but they were only forbidden for primary products if they resulted in a country having more than an equitable share of world export trade in that product.23 Conversely, in Article XI of the Subsidies Code, the contracting parties recognized that domestic subsidies “are widely used as important instruments for the promotion of social and economic policy objectives and do not intend to restrict the right of signatories to use such subsidies.”24 These domestic subsidies were permitted, but actionable by countervailing duties, subject to a material injury requirement, which was the main United States concession for the ban on export subsidies.

The Subsidies Code thus provided a two-track approach, permitting domestic subsidies and forbidding export subsidies.25 Unfortunately, the distinction between these two is not always clear. Furthermore, the Code did not define the term “subsidy,” but merely provided an illustrative list of permissible subsidies based on their actions and objectives.26 Yet, as the subsequent negotiations over the aircraft manufacturing industry illustrate, the most glaring failure of the Tokyo Round was that the permitted domestic subsidies were just as contentious and effective in distorting trade as the now-outlawed export subsidies.

10 McDonough, supra note 2, at 816.
11 See id. at 816-17.
12 See id. at 817; Subsidies Code, supra note 3, art. 11(1).
13 Subsidies Code, supra note 3, art. 9.
14 Id. art. 10(1).
15 Id. art. 11(1).
16 Id. arts. 9 & 11.
17 Id. art. 9 & Annex.
III. TWO DIFFERENT TRADE PARADIGMS

The subsidies question plagues the GATT talks primarily because the major negotiating teams, the United States and the European Community, have two fundamentally opposing historical attitudes towards subsidization.27 The European political systems have traditionally mingled the public and private sectors. This tradition was reinvigorated as Europe emerged from World War II, battered and bruised, and dependent on massive governmental support to rebuild its torn economies. The notion of government involvement in industry continues today.

Conversely, in the United States government encroachment anywhere was viewed suspiciously and was deemed acceptable only under rare circumstances. For example, the French believe that government is responsible for an individual's health and well-being from the cradle to the grave, whereas in the United States, governmental support is supposed to provide its citizens with a backstop to be used only in times of emergency. Similarly, much of European industry remains nationalized or dependent on governmental support, whereas in the United States, aid is only expected in times of emergency, such as the Chrysler bailout of the early 1980s.

The two systems' approaches to subsidies reflect these attitudes. The European Community views demands to limit domestic subsidies as interference with the responsibilities and rights of its national governments, whereas the United States sees them as an intrusion on the principles of the free market. "U.S. policy has been guided by an economic and political philosophy which presumes that subsidies distort resource allocations and international trade flows, undercut economic efficiency, and flout the law of comparative advantage by enabling the development and survival of otherwise uncompetitive industries."28


28 McDonough, supra note 2, at 844.
Recently, though, industry and government leaders have made ever-more persistent attempts to change this long-held view. Many scholars call for government “to reexamine the political economy and philosophical foundations of our trading rules.” Some point to the historical success of managed industries in the United States, such as agriculture and the railroads, as precedents for a new active governmental role. It appears that doctrinal reasons remain the main impediment to these calls for a new U.S. position. At a recent Senate hearing this difficulty was concisely framed in a response by the Chairman of Bell Laboratories:

Well, look, let us be blunt. If you use the term industrial policy, certain people close their ears and certain people reject what you are saying. . . . I think what we need to be discussing is what should we be doing to keep our industry competitive and what should we not be doing. And if that is called industrial policy, fine. I happen to agree.

This debate has been confused by the unclear subsidizing effects of the massive U.S. defense budget, which in many ways supports and finances industry research and production. The European Community frequently points out, and many in the United States agree, that this has the same practical effect on U.S. industry as more direct subsidies. Senator Patrick Moynihan stated curtly: “If [anyone] wants to know whether we should have an industrial policy, in the name of God for the last 45 years, we have had the most explicit industrial policy in the world. And that is the cold war.” Despite this apparent inconsistency of views, the “official U.S. position . . . is to avoid any active industrial policy, preferring . . . to let the market pick winners and

---


32 Id. at 68.
losers.’ An additional political concern with subsidization or industrial policy is that it results in increased government expenditures. At least since the Reagan years, the Republican party has consistently objected that industrial policy will lead to larger governmental interference, larger budget deficits, and greater inefficiency.

The negotiations between the United States and the European Community over aircraft subsidies reflect these two differing trade paradigms, exhibit the practical difficulties involved in reconciling them, and manifest the problem of how to account for U.S. defense expenditures in resolving the subsidies question. The European Community aircraft consortium, Airbus, has been a major success. Formed in 1968 by combining four European Community government-sponsored aircraft manufacturers, Airbus is now second only to Boeing in jet aircraft production. Airbus has shattered what was once an American monopoly. In the past decade, its share of the global aircraft market increased from seven percent in 1980 to twenty-seven percent in 1989, while the United States market share declined from eighty-seven percent to sixty-five percent.

This success has been achieved, in major part, through various types of direct and indirect subsidies, valued at up to $26 billion. These subsidies include development and program launch grants, funding of research programs, equity infusions, unpaid “loans,” and exchange rate guaran-

---


34 The consortium consists of the Deutsche Airbus unit of Germany’s Daimler-Benz AG, Britain’s British Aerospace PLC, France’s Aerospatiale, and Spain’s Casa.


37 See Airbus Report, supra note 35, at 24-36.
Additionally, a recent report commissioned by the U.S. Department of Commerce concluded that the Airbus had never made a profit on the sale of its aircraft and had never achieved "commercial viability." In fact, no one disputes that the industry is subsidized, but the European Community explains that its subsidization is necessary to provide technology, jobs, national prestige, and security, and that, in any event, since 1945 the United States has indirectly subsidized its own aircraft industry through defense expenditures. The U.S. industry, comprised of Boeing, McDonnell Douglas, and Hughes Aircraft, and represented by the Aerospace Industries Association (AIA), has long objected to the subsidization of Airbus, but has tempered its response. AIA is afraid that too much pressure on Airbus will alienate the European Community, freezing the U.S. aerospace industry out of the world's second largest market.

Despite these differences, the European Community and the United States both signed the Civil Aircraft Code of 1979 at the conclusion of the Tokyo Round. It was the Round's only industry-specific agreement. Throughout these negotiations, the United States and the European Community maintained their traditional positions. The United States maintained that the aircraft industry should operate on the basis of commercial competition, while the European Community wanted to continue its subsidies. The 1979 agreement ducked the subsidies question but liberalized aircraft trade by eliminating tariffs, prohibiting licensing requirements, and banning discriminatory procurement. However, this agreement did not cover aircraft subsidies, and its relationship with the Subsidies Code,

58 Id. at 24.
41 Id. at 37 (citing Gilbert R. Winham, International Trade and the Tokyo Round Negotiation 239 (1986)).
42 Id.
passed at the same time, was "uncertain from the start." Thus, heading into the Uruguay Round, the issue of aircraft subsidies was revealed.

IV. THE URUGUAY ROUND

A. THE AGREEMENT ON SUBSIDIES AND COUNTervAILING MEASURES

At the commencement of the Uruguay Round subsidies negotiations, the United States' foremost objective was to strengthen multilateral subsidy disciplines. The United States hoped to ban all export subsidies on both primary and non-primary goods, and extend domestic subsidies disciplines to other uncovered areas, such as industrial targeting, through clarification of terms and implementation of dispute settlement rules. Finally, the United States wanted to preserve the effectiveness of its countervailing duty law and practice. The Omnibus Trade and Competitiveness Act of 1988 summarized the U.S. strategy: "to define, deter, discourage the persistent use of, and otherwise discipline unfair trade practices having adverse trade effects, including forms of subsidy."

The European Community retained the same objectives that it had in the Tokyo Round. The European Community hoped to continue to use domestic subsidies as well as to limit the effectiveness of U.S. countervailing duty law. Its basic premise was that subsidies are legitimate policy tools to aid industries and regions in economic transition. The

43 Id. At the time, the aircraft industry expressed doubts as to future compliance that were justified by recent congressional testimony calling for ensuring European compliance. "[T]he U.S. Government should ensure that, as required by the GATT Civil Aircraft Code, Airbus prices fully reflect the recoupment of all costs . . . ." Financial Condition of the Airline Industry: Hearings before the Subcomm. on Aviation of the Comm. on Public Works and Transportation of the House of Representatives, 103d Cong., 1st Sess. 588 (1993) (testimony of Lawrence Clarkson, Corporate Vice President, The Boeing Co.).


45 Id.


47 See McDonough, supra note 2, at 845.
European Community looked to a definition of subsidies that would permit these types of aid. Furthermore, because of its more direct subsidization, the European Community hoped to measure subsidies by their cost to government, while the United States preferred measuring subsidies by the actual benefit received.

The U.S. aircraft industry played a complex role in the Uruguay Round because its size and strategic importance allowed it directly to influence the official U.S. negotiating position in the GATT. The industry, represented by the AIA, generally agreed with the U.S. position of demanding clearer definitions of subsidies, but it also wanted more effective dispute settlement, thereby "restoring credibility to the GATT process" and reducing the need for unilateral U.S. responses. The industry also wanted to shorten the proposed five-year grace period to bring subsidies into conformity and require a presumption of serious prejudice for all actionable subsidies. On the other side, Airbus agreed with the European Community's attempts to halt further limits on subsidization.

Eventually, the seven-year negotiations produced substantial limitations on subsidies use. Most importantly, after forty-five years of negotiations, the parties agreed on the definition of a subsidy. For GATT purposes, a subsidy is deemed to exist if "there is a financial contribution by a government or any public body within the territory of a Member" involving (1) a potential or actual "direct transfer of funds or liabilities;" (2) a foregone government revenue; (3) government provided goods or services separate from the infrastructure; or (4) "any form of income or price support in the sense of Article XVI of the GATT" which confers a benefit. This broad definition is narrowed by a require-
ment that the subsidy actually benefit an industry and a re-
requirement that the subsidy be "specific to an enterprise or
industry or group of enterprises or industries." The latter
requirement reflects U.S. countervailing duty law and main-
tains its distinctions, allowing sub-national (state) subsidies,
but prohibiting central government subsidies to a region,
even if generally available. The latter
requirement

The agreement then classifies subsidies into three
groups: prohibited, actionable, and non-actionable. Pro-
hibited subsidies are those contingent on export perform-
ance or upon the use of domestic over imported goods, and
are specifically set forth in Annex I of the agreement. Members are allowed three years to eliminate these prohib-
ited subsidies, which appear to include a ban on all export
subsidies (de jure and de facto) as well as local content
rules. Actionable subsidies are those that cause "adverse
effects to the interests of other members," defined as injury
to their domestic industry, nullification of GATT benefits,
or serious prejudice to another member's interests. Here,
a presumption of serious prejudice exists where (1) the to-
tal ad valorem subsidization of a product exceeds five per-
cent (based on the cost to the granting government); (2)
the subsidy covers direct forgiveness of debt; or (3) the sub-
sidy covers operating losses sustained by a single firm if pro-
vided on more than one occasion. The remedy provisions
of these first two categories clarify the means for demon-
strating the use of subsidies and create an obligation to re-
move them once identified.

52 Id. art. 2.1.
53 Lorentzen, supra note 44, at 13. For a critique of the specificity test see Trade
and Technology Hearings, supra note 93, at 42-45 (statement of Charles Owen Verrill,
Jr., adjunct Professor of International Trade Law, Georgetown University Law
54 Subsidies Code 1993, supra note 50, arts. 3-8; JACKSON ET AL., supra note 6, at
770.
55 Subsidies Code 1993, supra note 50, art. 3 & Annex I.
56 Lorentzen, supra note 44, at 13.
57 Subsidies Code 1993, supra note 50, art. 5.
58 Id. art. 6 & Annex IV. Note that article 6.7 exempts several specific subsidies
granted for non-trade based reasons.
59 Lorentzen, supra note 44, at 13.
The final category, non-actionable subsidies, includes safe harbor provisions for three types of subsidies. Into this category fall all subsidies which are non-specific as provided in Article II, as well as those for (1) general industrial research, if limited to seventy-five percent of eligible research costs, and fifty percent of precompetitive development activity; (2) regional development within areas that are neutrally determined to be disadvantaged; and (3) plant adaptation to environmental standards, as long as limited to twenty percent of a one-time operation.60

This is the first time the GATT specifically allows certain subsidies, a fact which, predictably, has caused strong opposition in the United States. In January 1994, forty-four Republican senators suggested to U.S. Trade Representative Mickey Kantor that they would vote against the GATT solely because these provisions “promote industrial policy.”61 The senators’ willingness to threaten to reject the seven-year agreement over this one issue exhibits the far-reaching potential and revolutionary nature of the new Subsidies Code.

This new Code seems to incorporate most of the U.S. demands, providing for subsidy measurements based on the benefit conferred to the recipient, as well as for more binding dispute resolution.62 The new Code also appears to deter questionable subsidies by setting out clear rules as well as providing for swift remedies. The new system should benefit U.S. research and development (R&D) programs that will no longer be vulnerable to foreign pressure to disclose their direction under the guise of unfair trade practice.63 In addition, the new system will benefit U.S. exporters of “clean technology” equipment and processes.64

---

60 Subsidies Code 1993, supra note 50, art. 8.

61 Sen. Danforth Seeks Way to End Dispute with Administration Over GATT Accord, Int'l. TRADE DAILY, Mar. 10, 1994, at D2. The article suggests that a compromise is possible based on the consultation and remedy provisions of Article 9.


63 Id.

64 Id.
The Subsidies Code also responds to U.S. demand by providing a shorter three year compliance period.\textsuperscript{65}

For these benefits, the United States had to agree to the adoption of the green light provisions which expressly allow certain subsidies.\textsuperscript{66} This major doctrinal concession is a boon for the European Community, where many explicit subsidy programs are already in place.\textsuperscript{67} Only time will tell whether this concession reflects, or will provoke, a new U.S. recognition of the benefits of industrial policy. This new system has the potential to cause fundamental changes in the U.S. economy if, as Republican critics insist, it encourages the increased use of government subsidies in these permitted areas.\textsuperscript{68} Yet the Subsidies Code also is significant for what it does not contain. Most notably it does not contain any agreement on the aircraft industry, the largest U.S. exporter. In the final days of negotiations, this single issue threatened to deny the world system all the benefits of seven years of hard work.\textsuperscript{69}

B. THE FIGHT OVER AIRCRAFT SUBSIDIES

Airbus and the U.S. aircraft manufacturers have claimed that they are subject to unfair competition.\textsuperscript{70} Each believes the other uses unfair trade practices to gain market leverage.\textsuperscript{71} In short, the United States position is that the Europeans are unfairly subsidizing their industry, making it difficult to compete, while Airbus believes that the U.S. manufacturers are also subsidized, albeit indirectly, through the massive U.S. defense program.\textsuperscript{72}

\textsuperscript{65} Subsidies Code 1993, supra note 50.
\textsuperscript{66} Id. art. 8.
\textsuperscript{67} See Airbus Report, supra note 35, at 21-31.
\textsuperscript{68} Sen. Danforth Seeks Ways to End Dispute with Administration Over GATT Accord, supra note 61, at D2.
\textsuperscript{70} See Airbus Report, supra note 35, at 9.
\textsuperscript{71} Id.
\textsuperscript{72} French Aircraft Industry Calls for Indirect Subsidies, INT'L Trade Daily, Dec. 22, 1993, at D8.
The GATT negotiations have traditionally been viewed as the proper forum to settle this dispute. The aircraft manufacturing industry holds a unique position in the GATT negotiations for several reasons. The industry is one of the world’s largest and, yet, is comprised of only a few players. Thus, especially in the United States, the industry leaders have an ability to formulate, and not just respond to, official policy. The market of buyers is also limited, demanding special deference to their concerns. For example, most industries, suspecting a GATT violation, would simply file a countervailing duty action, but the U.S. aircraft industry sees this option as unavailing:

The Europeans are much [closer] together and . . . in several cases the airlines are, in fact, controlled or owned in large part by the governments. They have made it quite clear that if we bring a countervailing duty case, they will immediately bring a like action against us and . . . we will be in a real trade war.73

After the limited success of the Tokyo Round, the United States waited until 1984 to begin negotiations with the European Community to "limit and eventually eliminate subsidies [like those] paid to Airbus."74 This process lingered for the rest of the decade, while "the U.S. civil aircraft industry sat quietly on the sidelines" and watched Airbus become the world's second largest manufacturer, replacing McDonnell Douglas.75 Although concerned with the GATT subsidies negotiations, the industry realized that the Civil Aviation Agreement of 197976 was not up for renegotiation

---

74 Id., supra note 39, at 141.
75 Id.
76 Agreement Concerning the Application of the GATT Agreement on Trade in Civil Aircraft of April 12, 1979 on Trade in Larger Civil Aircraft, July 17, 1992, U.S.-EC, available at Office of the United States Trade Representative Executive Office of the President, Washington, D.C., 20506 [hereinafter Agreement Concerning the Application of the GATT Agreement].
and that its best interests might be served in bilateral negotiations.\(^77\) In 1987, for the first time, the United States and the European Community began informal negotiations over limiting Airbus subsidies outside of the GATT framework to hedge against the possibility that the GATT might prove to be unsuccessful.\(^78\) One insightful industry spokesman cautioned that "we can expect to see many agenda items deferred again when the Uruguay Round comes to a close."\(^79\)

### 1. The German Exchange Rate Case

The bilateral negotiations yielded initial success. The United States moved from advocating a position of no government subsidies for development to conceding to a limit of twenty-five percent. The European Community representatives moved from a seventy-five percent limit to a forty to forty-five percent range.\(^80\) But here the parties stalemated, at least until the United States discovered an explicit export subsidy provided to Deutsche Airbus. In part because of pressure put on EC manufacturers by the declining dollar,\(^81\) the Airbus partner was provided exchange rate guarantees by its government, under the auspices of a privatization program, worth an estimated $2.5 million on each Airbus aircraft delivered in 1990.\(^82\) The U.S. team decided to bring a GATT action against the European Community in the hope of softening its intransigence in the negotiations.\(^83\) In January 1992, a GATT dispute panel ruled that the German program was in breach of the Subsidies Code because it was an export subsidy covered by the Annex to

---

\(^77\) AIRBUS REPORT, supra note 35, at 39.
\(^78\) Id.
\(^80\) AIRBUS REPORT, supra note 35, at 41.
\(^81\) Id. at 40.
\(^82\) Manner, supra note 39, at 148.
\(^83\) Id.
the 1979 Subsidies Code, subsection j, which prohibits certain exchange rate insurance programs.\textsuperscript{84}

This decision had two repercussions. First, it pointed out the ineffectiveness of the current GATT Subsidies Code, because the European Community later blocked adoption of the ruling, which was required for any remedial measures to be put in place.\textsuperscript{85} Second, it hastened the conclusion of the bilateral agreement, because it determined that the issue, although blocked, was nonetheless covered by the Subsidies Code and not just the evolving agreement.\textsuperscript{86} The importance of this distinction is twofold. First, the European Community was now on notice that its Airbus subsidies put it in the uncomfortable position of having to block future actions under the Subsidies Code. This ruling also made it apparent that the European Community system violated international law, as set forth by the GATT, an untenable position for a major trading power to keep for very long over such a hotly contested issue. After its victory, the United States brought a second, broader action under the Subsidies Code against Airbus subsidies.\textsuperscript{87} In response, the European Community finally lowered its development cap to the thirty to thirty-nine percent range.\textsuperscript{88}

2. \textit{The 1992 Civil Aircraft Agreement}

In July 1992, the European Community and the United States signed an agreement that provided a solution to the aircraft dispute.\textsuperscript{89} The agreement, which recognizes that disciplines in the GATT Civil Aircraft Code of 1979 "should be strengthened with a view toward progressively reducing the role of government support,"\textsuperscript{90} sets up a cap on subsi-

\textsuperscript{84} Id.
\textsuperscript{85} Id. at 149.
\textsuperscript{86} See Aerospace Industry Could Pull Support for Aviation-Compromised GATT, supra note 69, at 400.
\textsuperscript{87} Id.; Manner, supra note 39, at 150.
\textsuperscript{88} AIRBUS REPORT, supra note 35, at 42.
\textsuperscript{89} Agreement Concerning the Application of the GATT Agreement, supra note 76.
\textsuperscript{90} Id. at Preamble.
dies for developmental support at thirty-three percent of total development costs and requires a reasonable expectation of recoupment of these subsidies within seventeen years.\textsuperscript{91} The latter provision is designed to counter European Community allegations that its subsidies will be repaid. The more indirect aid given to aircraft development in the United States through the military budget is limited to three percent of annual industry turnover and four percent of the value of each firm's annual sales.\textsuperscript{92} The agreement only covers aircraft with more than one hundred seats and, importantly, calls for further negotiation under the GATT.\textsuperscript{93}

In exchange for these restraints, the United States "caved in on its longstanding position that defense contracts aren't subsidies for U.S. firms."\textsuperscript{94} This seems to be a reasonable and timely decision, because of the shrinking military budget. Despite this concession, the U.S. industry was pleased with the agreement. As a Boeing official explained:

[This agreement] will for the first time provide real disciplines over certain Airbus subsidies. The agreement includes a ban on production supports, which is noteworthy in that this is the first agreement in which a domestic subsidy is prohibited. Furthermore, the agreement provides for a cap, terms, and conditions on development funding which will dramatically reduce Airbus' ability to subsidize new aircraft models.\textsuperscript{95}

Of course, many problems still exist. The United States effectively managed to limit subsidies through this bilateral agreement to thirty-three percent of total development costs, down from previous European Community subsidies

\textsuperscript{91} Id.
\textsuperscript{92} Id. art. 5.
\textsuperscript{94} Aerospace Industry Wary of Looming Trade War, AEROSPACE DAILY, Nov. 16, 1992, at 245.
\textsuperscript{95} Improving the Competitiveness of U.S. Industry: Hearings before the Senate Comm. on Finance, 102d Cong., 2d Sess. 87 (1992) (statement of Lawrence W. Clarkson, Vice President, Planning and International Development, The Boeing Co.).
of about sixty percent, but this is still an enormous amount of subsidization. This concern over the amount of subsidization led the industry back to the GATT subsidies negotiations, where the United States tried to incorporate and strengthen the agreement and the European Community tried to back away from its previous commitments.

3. The Aircraft Industry and the Subsidies Negotiations

As attention focused on the GATT subsidies negotiations, the U.S. aircraft manufacturers and Airbus disagreed on the relationship between the 1992 agreement and the upcoming Subsidies Code. The U.S. negotiators wanted the talks to leave the 1992 Agreement intact and perhaps build on its commitments, while the European Community wanted a code that abrogated the bilateral agreement and made it harder for anyone to win relief under the GATT. The European Community also argued, alternatively, that the bilateral agreement implied that aircraft are excluded from coverage under the Subsidies Code, a reversal of the German Rate case.

The U.S. industry countered that "[a]ll efforts to exclude aircraft from the disciplines of any strengthened Subsidies Code must be resisted." The U.S. industry also wanted further dispute control mechanisms and urged the U.S. government for increased indirect support, such as financing from the U.S. Export-Import Bank. These arguments for a U.S. industrial policy were couched in terms of "greater government cooperation and understanding."

As 1993 progressed, the debate became more heated. The European Community claimed that the U.S. industry

---

96 U.S., EC Sign Agreement, supra note 93, at 1243.
97 McDonough, supra note 2, at 956.
98 Id.
99 Id. at 952 n.780, 956.
101 Id.
102 Id.
requests for additional indirect subsidies showed a lack of good faith and said that U.S. efforts to include aircraft in the GATT were "aimed at strangling the European aircraft industry." Simultaneously, the French minister "unveiled an $87 million program [subsidy] to promote quality in industrial production."104

As the GATT deadline of December 15, 1993 approached, the pressure mounted on both the European Community and the United States to come to some kind of agreement on this issue. But instead of striving towards consensus, the two sides began making further demands, because their respective industries were concerned that their governments would sacrifice industry interests for the GATT agreement as a whole. Each industry became nervous that it would be "used as a last minute bargaining chip" to reach a final overall accord. The European Community asked for a "grandfather clause" to the Subsidies Code, so that the agreement would exempt programs already in place, and for further restraints on indirect supports, accusing the U.S. industry of violating the four percent limit of the 1992 agreement.

United States leaders were in a difficult position. First, they wanted to ensure that there would be no retreat from the 1992 bilateral agreement, which placed a thirty-three percent cap on development subsidies. They also hoped for additional limits from the Subsidies Code. Their fear was that only one of the provisions, of only one of the trea-

---

104 Id.
106 See id.
107 Id.
109 Aerospace Industry Could Pull Support for Aviation-Compromised GATT, supra note 69, at 400.
110 Id.
ties, would apply. If that occurred, the European Community would either keep its thirty-three percent subsidies, or be able to subsidize according to the new code, which allows certain types of subsidies under its safe harbor provisions. The United States would then have to prove that each subsidy was one of the prohibited types, requiring excessive monitoring, litigation, and investigation that the leaders hoped to avoid.

4. The Agreement Not To Agree

In hindsight, it is easy to see that the two sides would be unable to resolve their differences before the GATT deadline of December 15, 1993. The European Community had recently given what it deemed substantial concessions in the 1992 bilateral agreement. Similarly, the United States was not about to backpedal from its thirty-three percent limit on subsidies, nor accept "a proposal that effectively excludes aircraft from coverage in the overall Subsidies Code." The U.S. industry believed that the only reason for reaching the 1992 agreement in the first place was because the GATT panel decided that Airbus subsidies were covered by the subsidies regime.

Furthermore, the GATT talks covered an estimated two trillion dollars in annual world trade, of which the aircraft industry accounted for only several billion dollars. As one Aerospatiale official put it, "[t]o let such a small amount spark what could be one of the most punishing tariff wars unleashed in recent memory would be 'absurd.' The aircraft subsidy issue had to be resolved by December 15, 1993, to assure passage of seven years of GATT negotiations in all the other areas.

---

111 Id.
112 Id.
113 Aerospace Industry Could Pull Support For Aviation- Compromised GATT, supra note 69, at 400.
114 Id.
115 Aerospace Industry Wary of Looming Trade War, AEROSPACE DAILY, Nov. 16, 1992, at 245.
Days before the December 15 deadline, executives of the U.S. aerospace industry wrote a letter to U.S. Trade Representative Mickey Kantor saying that the United States was "conceding much more than it obtains" and that their "bottom line" was that aircraft could not be excluded from subsidies coverage, nor subjected solely to it. Their concern was that if the Subsidies Code were the exclusive forum, the European Community would gain the advantage of being able to classify each of its individual subsidies into a permitted or non-actionable category of the new Subsidies Code. Also problematic was that "the EC would obtain the extension of disciplines on indirect supports into the multilateral dispute settlement procedure, a potentially damaging and far-reaching concession." As it stood under the 1992 agreement, only the direct supports were tallied to determine whether they exceeded the thirty-three percent cap. In an attempt to build on the 1992 agreement, the letter called for a one year period during which neither side would challenge subsidies under GATT.

The U.S. industry also desired the GATT agreement as a whole to receive the benefits of all other GATT provisions. Like the automobile industry, aircraft manufacturing is truly international in that components are shipped from all over the world. The industry could not afford to lose the benefit of the non-subsidy tariff reductions. The U.S. industry's position as of December 13, 1992 was summarized

---

117 See id.
118 Id. In fact, in Senate testimony, it was agreed that one could drive "a 747 through" the current subsidies code. U.S. International Trade Performance and Outlook: Competitive Position in the Automotive, Aerospace, and Chemical and Pharmaceutical Sectors: Hearing before the Subcomm. on Trade of the House Comm. on Ways and Means, 102d Cong., 2d Sess. 467 (1992) (statement of Lawrence Clarkson, Corporate Vice President, The Boeing Co.).
120 Aerospace Industry Could Pull Support for Aviation-Compromised GATT, supra note 69, at 400.
by an Aerospace Industry Association official: "We advanced an interim solution which said let's give ourselves a year to settle this problem on a good faith effort, and let's agree to extend the standstill on bringing people before (the GATT) for a violation."\textsuperscript{122}

Ultimately, the U.S. industry's proposal was accepted, though it resulted in "howls of protest from French and German industrialists"\textsuperscript{123} who believe that "the Americans are allowed to continue to provide unlimited support for their aerospace industry through indirect subsidies" because of a lack of enforcement of the 1992 agreement.\textsuperscript{124} Under the final proposal, the aircraft industry is temporarily covered under the 1979 Subsidies Code with the new dispute resolution of the Uruguay Round.\textsuperscript{125} While it appears that the U.S. industry gained the final advantage, this is only because the Europeans almost succeeded in abrogating the 1992 agreement or gaining exclusive GATT coverage. In short, neither side won, but the battle remains for another day.

5. \textit{The Next Time}

After all of the last-minute drama, the bottom line is that the aircraft subsidy negotiations are back where they started. The industry, however, will receive its share of the predicted $300 billion of trade benefits from the overall GATT package.\textsuperscript{126} The U.S. industry appears to be pleased with the GATT talks, proclaiming that "despite a very tough negotiating position from the EC, . . . the United States negotiators supported the aerospace industry."\textsuperscript{127} The AIA

\begin{itemize}
  \item \textsuperscript{122} Id.
  \item \textsuperscript{123} \textit{U.S., Europe Set Aside Aviation Dispute To Speed Uruguay Round}, \textit{AEROSPACE DAILY}, Dec. 14, 1993, at 415.
  \item \textsuperscript{125} Id.
  \item \textsuperscript{126} See \textit{U.S., Europe Set Aside Aviation Dispute To Speed Uruguay Round}, supra note 123, at 415.
  \item \textsuperscript{127} \textit{Many in Industry Support GATT Accord}, supra note 119, at D11 (statement of Don Fuqua, President AIA).
\end{itemize}
released a white paper, claiming that the resolution's principal benefits are coverage of aircraft components under the Subsidies Code, access to new dispute settlement procedures, and the refusal to exclude aircraft subsidies from the new Code.\footnote{128}

Unfortunately, the negotiations may be more challenging the second time around. The United States now has the added problem of negotiating around two "footnotes" that were added to the Subsidies Code at the very last minute: the "first gives some added protection to the kinds of subsidies used in Europe... [and] the second makes it harder for countries looking for GATT relief to prove that a given subsidy distorts the market."\footnote{129} The two sides, furthermore, used up substantial energy and resources over the GATT fight and perhaps also lost their trust and willingness to work together.\footnote{130}

Recently, the European Community accused the United States of trying to "dismantle Europe's system of support," while guaranteeing impunity for its own.\footnote{131} The French industry has asked its government for additional indirect subsidies, so that the European Community may negotiate on equal terms with the United States next time.\footnote{132} President Clinton has already called for close monitoring of the European Community subsidies to ensure compliance with the 1992 agreement, and he has called for the use of American embassies to "track and report" on the actions of the Airbus countries.\footnote{133} Whether this is simply a return to rhetoric now that the pressure is off remains to be seen, but, while the two sides have agreed to a one year extension, it is fortu-
nate that they actually have until the middle of 1995 (when
the 1992 agreement expires) to come to a compromise.

V. CONCLUSIONS

The Uruguay Round subsidies negotiations taught us sev-
eral lessons. First, the Round affirmed that the sheer scope
of the GATT talks assures their successful completion. In
the final days of negotiations there were several additional
contentious areas, such as labor standards and motion pic-
ture quotas. Yet there was already too much at stake to al-
low these formidable obstacles to halt seven years of
negotiations. In fact, the intensity of these disputes reflects
the parties' actual commitment to the GATT process. Yet
there are a few troubling aspects to these last minute ma-
neuvers. First, many countries outside of the United States
and European Community complained that in the final
days they were all but ignored, leading to feelings of
marginalization from the GATT talks and the world econ-
omy. The two parties' brinkmanship has led other coun-
tries to reassess their influence in the GATT talks.

Second, leaving vital sectors of the world economy out of
GATT agreements is a dangerous precedent. If major in-
dustries are excluded from GATT coverage, its overall effec-
tiveness is lessened, as is the incentive for further GATT
negotiations. Bilateral agreements are less likely to demand
principled reductions of world trade barriers, the original
GATT mission. Specifically, failure of the aircraft negotia-
tions provides little hope for a resolution under any new
GATT talks and increases the likelihood of some kind of
adjustment in the 1992 bilateral agreement.

Conversely, many commentators view the omission of ma-
jor industries from the talks in a more favorable light. They
point out that certain industries, like the aircraft industry,
are unique and that fragmentation of negotiations is the
most effective way for resolution. But this argument seems
to miss the fundamental point of the GATT: reduction of

---
artificial barriers to increase world prosperity. Allowing individual industry exemptions removes any pressure for multilateral negotiation. Taken to an extreme, this would render the GATT useless. One author summarized the theory of comparative advantage applicable to the aircraft industry: "as a large economy of 224 million people, the U.S. is going to enjoy advantages, like economies of scale, that lend themselves to having a strong industry in large, capital-intensive goods like aerospace." The point is that the involvement of non-economic but real world concerns, such as national prestige, should not result in automatic exemption from the GATT.

Third, the passage of safe harbor exclusions for certain subsidies strains the doctrinal underpinnings of the GATT. The GATT is supposed to reduce artificial trade barriers. These safe harbors for research and development, environmental adjustment, and regional development are subsidies, otherwise known as trade barriers, or elements of industrial policy. Regardless of the semantics, these provisions signal an implicit movement away from the free market principles of the GATT to a more managed atmosphere. The United States may soon embrace a new trade paradigm, one requiring fundamental restructuring of certain parts of our economy.

Fourth, the United States must recognize the hypocrisy in its belief that the defense budget is not a form of industrial policy. Hopefully, this will receive full and frank discussion during the congressional implementation debate. The January 1994 declaration by forty-four Senate Republicans that they would oppose GATT implementation because it promotes industrial policy may force the United States to come to terms with its position on government-industry partnerships. In fact, this process has already begun. United States Deputy Trade Representative Rufus Yerxa recently advised Congress not to be concerned that the new greenlighted subsidies would allow other countries an edge over the

---

United States because the United States already provides more research and development programs than any other country.\textsuperscript{196} It is no coincidence that the aircraft industry, the industry that benefited the most from the cold war defense budgets, is one of the first to call for explicit recognition of the need for a new industrial policy.

While industrial policy runs counter to the original GATT mandate, it may be the most effective means to advance national policy after the cold war. It is difficult to imagine that the United States or any other power could ever commit the kind of resources to industry that have been committed to defense. Nonetheless, the most profound result of the negotiations may be what is not recognized in the agreement: an implicit turning away from the original GATT mission. If industrial policy becomes widely accepted, then what is the place of GATT negotiations in a spiral of increasing government support to industry?

Finally, we must ask whether the GATT is a forum that may prove effective in the future. Future negotiations may make the debate over subsidies appear to be a mere playground squabble, as the GATT expands to include more sensitive topics such as workers' rights and environmental concerns. These will bring new constituencies into the negotiations and redefine traditional country alignments and interest group positions. It seems that perhaps the GATT is moving away from its economic mission toward a more social orientation. As this occurs, we must remember to ask ourselves whether it is wise to risk world recession, one potential result of a failed GATT negotiation, in order to motivate agreement on such subjective goals.

Current Literature