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BRAZIL – EXPORT FINANCING PROGRAMME FOR AIRCRAFT

AB-1999-1

Report of the Appellate Body

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WORLD TRADE ORGANIZATION
APPELLATE BODY

Brazil – Export Financing Programme for Aircraft

Brazil, *Appellant/Appellee*

Canada, *Appellant/Appellee*

European Communities, *Third Participant*
United States, *Third Participant*

AB-1999-1

Present:

El-Naggar, Presiding Member

Bacchus, Member

Ehlermann, Member

I. Introduction

1. Brazil and Canada appeal from certain issues of law and legal interpretation in the Panel Report, *Brazil – Export Financing Programme for Aircraft* (the "Panel Report").¹ The Panel was established to consider a complaint by Canada with respect to certain export subsidies granted under the Brazilian *Programa de Financiamento às Exportações* ("PROEX") on sales of aircraft to foreign purchasers of Empresa Brasileira de Aeronáutica S.A. ("Embraer"), a Brazilian manufacturer of regional aircraft.²

2. The Panel described certain factual aspects of PROEX at paragraphs 2.1 to 2.6 of the Panel Report. Below we provide a summary of these factual aspects, focusing on the details relating to interest rate equalization subsidies under PROEX to the regional aircraft industry.

3. PROEX is administered by the Comitê de Crédito as Exportações (the "Committee"), an inter-agency group within the Ministry of Finance in Brazil. Day-to-day operations of PROEX are conducted by the Bank of Brazil.³ Under PROEX, the Government of Brazil provides interest rate equalization subsidies for sales by Brazilian exporters, including Embraer.

¹WT/DS46/R, 14 April 1999.

²The Panel noted that, in its submissions, Canada defines the regional aircraft market as consisting of commercial aircraft with 20-90 seats, whether turboprop or jet. Panel Report, footnote 188.

³*Ibid.*, para. 2.4.

4. For sales of regional aircraft, PROEX interest rate equalization subsidies amount to 3.8 percentage points of the actual interest rate on any particular transaction.⁴ The lending bank charges its normal interest rate for the transaction, and receives payment from two sources: the purchaser, and the Government of Brazil. Of the total interest rate payments, the Government of Brazil pays 3.8 percentage points, and the purchaser pays the rest. In this way, PROEX reduces the financing costs of the purchaser and, thus, reduces the overall cost to the purchaser of purchasing an Embraer aircraft.

5. The involvement of PROEX in aircraft financing transactions begins when the manufacturer – Embraer – requests approval for PROEX interest rate equalization subsidies before the conclusion of a formal contract with a buyer. If the Committee approves the request, it then issues a letter of commitment to the manufacturer, committing the Government of Brazil to PROEX support, provided that the buyer and the manufacturer conclude a contract for the transaction within a specified period of time, usually 90 days (subject to renewal), and in accordance with the terms and conditions set forth in the original request.⁵ The letter of commitment usually provides that PROEX payments will be made in 30 equal and consecutive semi-annual instalments during a financing period of 15 years. The first instalment payment is typically due six months after the delivery date of each aircraft.⁶

6. PROEX interest rate equalization subsidies begin after the aircraft is exported and paid for by the purchaser. The payments are made in the form of bonds issued by PROEX to the financing institution. After each export transaction is confirmed, the Bank of Brazil applies to the National Treasury of Brazil for the issuance of bonds designated as National Treasury Note – Series I ("NTN-I") bonds. The National Treasury issues these bonds and transfers them to the Bank of Brazil, which in turn passes the bonds to the lending bank (or its agent bank). The lending bank can redeem the bonds on a semi-annual basis for the duration of the financing, or can sell them on the market at a discount immediately upon receipt.⁷ NTN-I bonds are denominated in Brazilian currency, indexed to the dollar as of the date the bonds are issued. The bonds can only be redeemed in Brazil, and only in Brazilian currency.⁸

7. The Panel considered claims by Canada that PROEX is inconsistent with the prohibition on export subsidies under Article 3.1(a) of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*"). The Panel Report was circulated to the Members of the World Trade Organization (the "WTO") on 14 April 1999. The Panel reached the conclusion that PROEX interest

⁴Panel Report, para. 2.3.

⁵*Ibid.*, para. 2.5.

⁶*Ibid.*, para. 2.6; sample letter of commitment provided by Brazil.

⁷*Ibid.*, para. 2.6.

⁸*Ibid.*

rate equalization payments are subsidies within the meaning of Article 1 of the *SCM Agreement*, and are contingent upon export under Article 3.1(a) of that Agreement. In reaching this conclusion, the Panel found that the PROEX interest rate equalization payments were not "permitted" under the first paragraph of item (k) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* (the "Illustrative List"). The Panel also found that Brazil failed to comply with certain of the conditions of Article 27.4 of the *SCM Agreement*, and that, therefore, the prohibition in Article 3.1(a) of the *SCM Agreement* applied to Brazil.⁹ Having found that PROEX payments are inconsistent with Article 3.1(a), the Panel recommended that Brazil withdraw the subsidies within 90 days pursuant to Article 4.7 of the *SCM Agreement*.¹⁰

8. On 3 May 1999, Brazil notified the Dispute Settlement Body (the "DSB") of its intention to appeal certain issues of law covered in the Panel Report and legal interpretations developed by the Panel, pursuant to Article 4.8 of the *SCM Agreement* and paragraph 4 of Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), and filed a Notice of Appeal pursuant to Rules 20 and 31(1) of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). On 13 May 1998, Brazil filed its appellant's submission.¹¹ On 18 May 1998, Canada filed its own appellant's submission.¹² On 28 May 1998, Brazil¹³ and Canada¹⁴ both filed appellee's submissions. On the same day, the European Communities and the United States filed third participant's submissions.¹⁵

9. As described more fully in Section III of this Report, by joint letter of 27 May 1999, Brazil and Canada requested that the Appellate Body apply, *mutatis mutandis*, the Procedures Governing Business Confidential Information adopted by the Panel in this case. A preliminary hearing on this issue was held on 10 June 1999, with this Division sitting jointly with the Division of the Appellate Body hearing the appeal in *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft*"),¹⁶ and a preliminary ruling was issued by this Division on 11 June 1999.

⁹Panel Report, para. 8.1. We note that for the purposes of determining whether there was an increase in "the level of ... export subsidies" under Article 27.4, the Panel examined subsidies under PROEX, and also under BEFIEX, which provides tax relief to exporters. Panel Report, paras. 4.160 and 7.75.

¹⁰*Ibid.*, paras. 8.2 and 8.5.

¹¹Pursuant to Rule 21(1) of the *Working Procedures*.

¹²Pursuant to Rule 23(1) of the *Working Procedures*.

¹³Pursuant to Rule 23(3) of the *Working Procedures*.

¹⁴Pursuant to Rule 22 of the *Working Procedures*.

¹⁵Pursuant to Rule 24 of the *Working Procedures*.

¹⁶WT/DS70/AB/R, circulated to WTO Members on 2 August 1999.

10. The oral hearing in the appeal was held on 17 June 1999. The participants and third participants presented oral arguments and responded to questions put to them by the Members of the Division hearing the appeal.

II. Arguments of the Participants and the Third Participants

A. *Claims of Error by Brazil – Appellant*

1. Consultations

11. As appellant, Brazil argues that certain measures about which the parties did not consult were not properly before the Panel. Specifically, Canada's July 1998 request for the establishment of a panel referred to certain Brazilian measures that were enacted in 1997 and 1998, long after consultations had concluded. Those measures are: Provisional Measure 1700/15, Provisional Measure 1629/13, Decree No. 2414 of 12/9/97, Resolution of the National Monetary Council No. 2490/98, Resolution of the National Monetary Council No. 2452/97, Resolution of the National Monetary Council No. 2381/97, Resolution of the National Monetary Council No. 2380/97, MICT Order 28/98, MICT Order 23/98, MICT Order 7/98, MICT Order 121/97, MICT Order 83/97, MICT Order 53/97, MICT Order 34/97, and MICT Order 33/97.¹⁷ As these measures did not exist at the time Canada's request for the establishment of the Panel was made, Brazil maintains that these measures were not properly before the Panel.

12. Brazil argues that the Panel erred in concluding that these 1997 and 1998 measures were properly before it. The Panel came to this conclusion because "the request for consultations related to the same general subject as the request for establishment of a panel, i.e., 'export subsidies under PROEX'"¹⁸, and that "the consultations and request for establishment relate to what is fundamentally the same 'dispute', because they involve essentially the same practice, i.e., the payment of export subsidies under PROEX."¹⁹

13. In Brazil's view, the issue is whether particular measures that the parties themselves acknowledge were neither included in the consultation request nor the subject of consultations can, nevertheless, properly be before a panel. Article 4.7 of the DSU provides that a complainant may request the establishment of a panel only if "the consultations" fail to settle a dispute. A request for the establishment of a panel must include only measures that were either identified in the request for

¹⁷Panel Report, para. 4.1.

¹⁸*Ibid.*, para. 7.8.

¹⁹*Ibid.*, para. 7.11.

consultations or raised subsequently during the consultations. Brazil contends that both Article 6.2 of the DSU and Article 4.4 of the *SCM Agreement* provide a necessary and limiting connection between the subject matter of the panel request and the subject matter of the consultations.

2. Are PROEX Interest Rate Equalization Payments Used "To Secure a Material Advantage in the Field of Export Credit Terms"?

14. Brazil acknowledges that the PROEX interest equalization scheme is a subsidy under Article 1 of the *SCM Agreement* that is contingent upon export under Article 3.1(a) of that Agreement. Nonetheless, Brazil argues that PROEX interest equalization payments for aircraft are "permitted" by the terms of item (k) of the Illustrative List. Under the express terms of item (k), government payment in support of export credit constitutes a prohibited export subsidy only "in so far as they are used to secure a material advantage in the field of export credit terms". It follows, *a contrario*, that they do not constitute prohibited export subsidies if they are not used "to secure a material advantage in the field of export credit terms." Moreover, PROEX payments are not, in fact, used "to secure a material advantage in the field of export credit terms." Therefore, according to Brazil, PROEX payments are allowed under the *SCM Agreement*.

15. Brazil also argues that the justification for the PROEX subsidies are twofold. First, PROEX subsidies simply compensate for higher interest rates incurred on transactions involving Embraer that result from what it terms "Brazil risk". "Brazil risk" occurs because a Brazilian commercial entity cannot avoid bearing the additional cost of Brazil sovereign risk when it raises capital or finances a purchase or a sale. Brazil sovereign risk results from the perception in the market for debt securities as to the likelihood of repayment on schedule.²⁰ Brazil presented evidence to the Panel that PROEX payments are not "used to secure a material advantage" on *two types* of transactions: transactions in which the lender is a financial institution *inside* Brazil; and transactions in which the lender is *outside* Brazil. When the lender is inside Brazil, PROEX offsets the "Brazil risk" incurred by the *lender*. When the lender is outside Brazil, *Embraer itself* incurs "Brazil risk". According to Brazil, the Panel and the other participants ignored the distinction between these two types of transactions, and ignored the fact that Brazil offered separate arguments that these two types of transactions do not "secure a material advantage".

16. Brazil contends that, PROEX subsidies are intended to "match" the subsidies provided by the Government of Canada to Bombardier. Canada provides a wide range of subsidies for Canadian regional aircraft, and these subsidies reduce the price of the aircraft.

²⁰Panel Report, paras. 4.94-4.96.

17. In support of its position, Brazil notes first that the verb "secure", which is found in the "material advantage" clause of item (k), has been defined to mean "succeed in obtaining or achieving; gain possession of" and "to procure". The verb "secure" (or "securing") is used no fewer than 14 times in WTO Agreements, and, that, in every instance the word "obtain" (or "obtaining") would be an accurate synonym. "Secure" is used in this sense in item (k) as well, referring to action by a Member to obtain, to gain possession of, or to procure a material advantage "in the field of export credit terms" for itself or its nationals, such as Embraer. Brazil maintains that the Panel's interpretation leads to an interpretation of item (k) that covers action by Brazil to "confer" or "bestow", by providing more favourable financing terms, a material advantage on the nationals of other Members who purchase from the Brazilian exporter.

18. Next, Brazil argues that the Panel's interpretation reduces the "material advantage" clause to "redundancy or inutility" by construing the clause to include within this prohibition nothing more than payments that improve "the terms that would otherwise have been be [sic] available to the purchaser with respect to the transaction in question."²¹ The Panel's interpretation of the "material advantage" clause adds nothing to item (k) because all payments of costs incurred will improve the terms that would have been available in their absence.

19. Also, Brazil contends that the Panel's interpretation is inconsistent with the context of the "material advantage" clause. Footnote 5 of the *SCM Agreement* specifies that Annex I contains not only a list of prohibited exported subsidies, but also measures that do not constitute export subsidies, such as in items (b), (h), (i) and (k). Comparing the structure of item (j) and item (k), the two provisions share a similar structure in that they define practices that constitute prohibited export subsidies with language that limits the scope of the definition. In the case of item (j) regarding export credit guarantee or insurance programmes, the limiting language is "premium rates which are inadequate to cover the long-term operating costs and losses of the programmes." In the case of item (k) regarding export credit terms, the limiting language is "in so far as [government payments] are not used to secure a material advantage in the field of export credit terms." Thus, practices covered by the first paragraph of item (k) are prohibited only "in so far as they are used to secure a material advantage in the field of export credit terms." Otherwise, Brazil contends, they are, *a contrario*, permitted.

20. In addition, Brazil asserts that its interpretation is confirmed both by the preparatory work relating to the *SCM Agreement* and by the circumstances that led to the inclusion of the "material advantage" clause in item (k). The language that now comprises the first paragraph of item (k),

²¹Panel Report, para. 7.37.

without the "material advantage" clause, had its origins in rules adopted in 1958 by the Organization for European Economic Cooperation. The provision was included *verbatim* in a 1960 Report of a GATT Working Party on Subsidies. This report provided the basis for the Illustrative List of Export Subsidies in the *Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade* (the "*Tokyo Round SCM Code*"), which was concluded in 1979. The previous year, in 1978, just prior to the conclusion of the Tokyo Round, the Organization for Economic Cooperation and Development (the "OECD") concluded the *OECD Arrangement on Guidelines for Officially Supported Export Credits* (the "*OECD Arrangement*"). Because the *OECD Arrangement* expressly permitted the provision by governments of certain export credits, an exception was inserted by the Tokyo Round negotiators as the second paragraph of item (k) for practices that conform to the interest rate provisions of certain international undertakings on export credits – the "safe harbour" clause. Some time after deciding to include this OECD "safe harbour" clause, the GATT negotiators added the "material advantage" clause to the first paragraph of item (k). According to one of the negotiators at the time, the "material advantage" clause was intended to provide "a weak injury test in the event of a departure from the basic GATT [subsidy] standard." The "material advantage" clause was intended to restrict the definition of this type of export subsidy to instances where a "material advantage" has been "secured". If no "material advantage" is secured, no export subsidy exists. Thus, Brazil concludes that the Panel's interpretation of the "material advantage" clause denies the words of that clause any meaningful effect and should therefore be reversed.

21. Finally, with respect to the availability of item (k) as an "affirmative defence", Brazil notes the Panel's concern that Brazil's interpretation could lead to "inconsistent results"²², because a measure in the form of a payment could be found to be a prohibited export subsidy when challenged by one complainant yet found not to be a prohibited subsidy when challenged by a different complainant. Brazil responds that such "inconsistent" results are both anticipated and permitted by a number of covered agreements, including Part III and Part V of the *SCM Agreement*, as well as the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* and the *Agreement on Safeguards*.

²²Panel Report, para. 7.27.

3. Has Brazil Increased the Level of its Export Subsidies?

(a) Actual Expenditures or Budgeted Amounts

22. Brazil states that in determining whether Brazil has increased the level of subsidies in a manner inconsistent with Article 27.4 of the *SCM Agreement*, the criterion should be the budgeted amounts, not the level of expenditure. The Panel's conclusion on this issue was in error.

23. Brazil first notes that PROEX budgetary numbers are not simply estimates of amounts to be paid, but are actual appropriations that may be used by beneficiaries of the programme. The appropriate definition of the word "grant" in footnote 55 is "agree to, promise, undertake". The result of the budgetary appropriation is that Brazil agrees to, promises, and undertakes to make a specified amount of funds available in the next fiscal year to the private sector for export subsidies under PROEX. Brazil argues that its budgetary appropriations have been "granted", as used in the context of footnote 55, and are, therefore, the appropriate basis for determining the level of export subsidies.

24. In Brazil's view, the context provided by Article 25 of the *SCM Agreement* confirms that the budgeted amount of subsidies is the relevant criterion for calculating the increase in the level of export subsidies under Article 27.4. Article 25 provides that notifications shall contain the "subsidy per unit or, in cases where this is not possible, the total amount or the annual amount budgeted for that subsidy" Because PROEX payments are not provided on a per unit or lump sum basis, Brazil, in accordance with Article 25.3(ii), notified PROEX on the basis of the annual amount budgeted. Nothing in Article 27 suggests, let alone supports, the notion that Members should use one basis for notifying the level of their subsidies under Article 25 of the *SCM Agreement* and another basis for determining whether the level of export subsidies has increased for purposes of Article 27.4.

(b) When are PROEX Subsidies "Granted"?

25. Brazil argues that a subsidy occurs within the meaning of Article 1 of the *SCM Agreement* when the Brazilian authorities issue a letter of commitment to the parties to a proposed transaction. The Panel's conclusion that the letter of commitment itself is not a subsidy, because it is neither a direct transfer of funds nor a potential direct transfer of funds under Article 1.1 of the *SCM Agreement*, was erroneous. Neither the text of the *SCM Agreement* nor logic supports the Panel's finding that in order to qualify as a "potential direct transfer of funds" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*, a measure must give rise to a benefit and thus confer a subsidy irrespective of whether any payment occurs. The ordinary meaning of "potential direct transfer of funds" includes a letter of commitment, and Brazil notes the Panel's statement that the word "potential" has been defined as "possible as opposed to actual" or "capable of coming into being." These definitions apply not only to loan guarantees expressly mentioned in Article 1.1(a)(i)

of the *SCM Agreement*, but also to the PROEX letters of commitment. The letter of commitment makes PROEX support "possible" and "capable of coming into being", and therefore constitutes a "potential direct transfer of funds". The letter of commitment benefits Embraer by permitting it to offer its potential customers financing on terms more favourable than it would be able to offer otherwise. This benefit exists *regardless* of whether a formal contract is signed. In Brazil's view, Canada acknowledges this point in its assertion that Brazil has "intensified" subsidization by making long-term commitments in recent months.

26. Brazil also argues that the Panel's finding on this issue is contrary to its statement that "the object and purpose of the *SCM Agreement* ... is to reduce economic distortions caused by subsidies."²³ Although Brazil denies that PROEX subsidies cause economic distortions, any distortions that would be caused by such subsidies would occur at the time the letter of commitment was issued, for it is this commitment that determines whether the purchaser awards the contract to Embraer or to a competitor.

27. Finally, Brazil notes that, under domestic law, the Government of Brazil is "legally liable" for damages should it fail to provide a PROEX payment to which it is committed by virtue of a letter of commitment, when private parties have acted in good faith in reliance on this commitment. Thus, a ruling by the Appellate Body that PROEX subsidies that have already been committed must be withdrawn would force Brazil to violate its domestic legal obligations. An interpretation of the *SCM Agreement* that would require Members to breach their contractual financial commitments would be "unfortunate" from the perspective of both the international trading and financial systems.

4. Recommendation of the Panel

28. Brazil notes that Article 4.12 of the *SCM Agreement* provides that, when specific time periods are not provided by Article 4, "time-periods applicable under the DSU for the conduct of such disputes shall be half the time prescribed therein." Brazil disagrees with the Panel's conclusion that Brazil should withdraw its export subsidy within 90 days, instead of within the seven and one-half months that would be half the 15-month period set out in Article 21.3(c) of the DSU. Brazil does not contend that 90 days or some other period (including a longer period) might not be appropriate in a particular case. However, there must be good reason for such a conclusion. The Panel's "brief, cursory treatment of the question" provides "no reason whatsoever" for departing from the seven and one-half month "standard" provided by Article 4.12 of the *SCM Agreement* and Article 21.3(c) of the DSU.

²³Panel Report, para. 7.66.

B. *Arguments by Canada – Appellee*

1. Consultations

29. Canada agrees with the Panel's finding that "the consultations and request for establishment [of a panel] relate to what is fundamentally the same 'dispute', because they involve essentially the same practice, i.e., the payment of export subsidies under PROEX."²⁴ In this case, Canada's request for consultations, dated 18 June 1996, was made under Article 4 of the *SCM Agreement* and Article 4 of the DSU, in respect of "certain export subsidies granted under the Brazilian *Programa de Financiamento às Exportações* (PROEX) to foreign purchasers of Brazil's Embraer aircraft."²⁵ Canada's request for a panel, dated 10 July 1998, was in respect of "the payment of export subsidies through interest rate equalization and export financing programmes under PROEX."²⁶ The measures alleged by Brazil to have been improperly before the Panel as of 10 July 1998 constitute the legislative and regulatory basis for the granting of the PROEX subsidies. The specific instruments set out in its request for the establishment of a panel merely reflect amendments and replacements to the measures underlying PROEX. In Canada's view, the measures at issue form the continuing legislative and regulatory basis for PROEX subsidy payments, which were the "matter" in the request for consultations and in the request for establishment of a panel.

2. Are PROEX Interest Rate Equalization Payments Used "To Secure a Material Advantage in the Field of Export Credit Terms"?

30. Canada notes Brazil's claim that whether export credit terms "secure a material advantage" should be based on the terms available in the "marketplace", which, according to Brazil, includes the terms available to all companies in the industry from private and public sources. Canada disagrees with this interpretation, and submits that "material advantage" refers to export credit terms that provide an advantage to a purchaser over the terms otherwise available in the private international financing market. The Panel followed this approach, and specifically rejected Brazil's argument, stating, *inter alia*, that such an approach could lead to a "race to the bottom" in which Members justified the provision of export subsidies on the grounds that other Members were providing them as well.

31. Canada contests Brazil's interpretation that PROEX payments are not "used to secure a material advantage" in the sense of item (k) because they are designed to offset Brazil's risk and Canada's level of subsidies. PROEX export subsidies are, in fact, "used to secure a material

²⁴Panel Report, para. 7.11.

²⁵WT/DS46/1, G/SCM/D3/1, 21 June 1996.

²⁶WT/DS46/5, 13 July 1998.

advantage", as they provide credit terms for the purchaser more favourable than those that could be obtained in the market. Where a government, financial institution, exporter or purchaser uses an export credit or a payment to gain an advantage or benefit for a beneficiary (i.e., purchasers of exported goods) relative to the international financing market, such practice "secure[s] a material advantage" under item (k) and is an export subsidy prohibited by Article 3.1.

32. Canada rejects Brazil's claim that the Panel's analysis reduces the "material advantage" clause to a nullity. The Panel's finding was that the "material advantage" clause is used to determine whether the subsidy puts the recipient in a better position than if the recipient had obtained financing without government support in the international financing market. Item (k) refers to a situation where a government lends funds at an interest rate that is below the rate it would pay for raising such funds or a similar situation where the government makes up for costs incurred by private lenders. The "material advantage" clause provides that such practice is an export subsidy only when the resulting terms are more favourable than those available in the international financial markets. Without the "material advantage" clause, simply lending below the cost of funds or paying the costs incurred by exporters or financial institutions in obtaining credits would be an export subsidy regardless of the financing terms that result. It is possible for a government to correct for high costs of country risks without providing terms that are more favourable than those available on the market. Therefore, Canada concludes that the "material advantage" clause is not reduced to a nullity under the Panel's interpretation.

33. Canada states also that Brazil's reliance on the negotiating history is misplaced, because neither Canada nor the Panel has denied that the "material advantage" clause should be given meaning.

34. Canada rejects Brazil's interpretation that PROEX payments are permitted under item (k) on an *a contrario* basis. Such interpretation would convert the Illustrative List into an exhaustive list of prohibited export subsidies, which it is not. The use of the word "including" in Article 3 of the *SCM Agreement* clearly indicates that there are measures other than those listed in the Illustrative List that could be covered by Article 3. Thus, the use of *a contrario* inferences in the Illustrative List is inappropriate. According to Canada, Brazil's interpretation is not supported by footnote 5, which provides that "measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement."

35. Canada notes that there is nothing in the first paragraph of item (k) that indicates that measures not meeting the item (k) criteria are to be "permitted" under footnote 5. The Brazilian argument for an *a contrario* finding that certain measures are "permitted" under the Illustrative List

should be rejected because, instead of a "list with numerous references to what is an export subsidy", the Annex becomes "a list with numerous references to what is not an export subsidy." Moreover, nothing in the text of the *SCM Agreement* supports the view of the United States that each item in the Illustrative List "sets forth the standard" for when a particular type of measure is a subsidy.

36. Finally, Canada addresses the question of whether PROEX results in a "payment" within the meaning of item (k). The first part of the first paragraph of item (k) refers to a situation where a government lends funds at an interest rate that is below the rate it would pay for raising such funds. The phrase "the costs incurred ... in obtaining credits" in the second part of item (k) refers to a similar situation, but with private financing. PROEX subsidies have little to do with Embraer's cost of raising funds to provide financing. In fact, PROEX export subsidies are typically paid when sales are financed by non-Brazilian financial institutions. The higher cost of credit due to "Brazil risk" is not an issue. Thus, PROEX subsidies are not payments to cover the added costs incurred by exporters or Brazilian financial institutions in raising funds used for financing purchases. In Canada's view, they are simply cash grants made for the benefit of purchasers of Brazilian exported products, and do not constitute payments within the meaning of the first paragraph of item (k).

3. Has Brazil Increased the Level of its Export Subsidies?

(a) Actual Expenditures or Budgeted Amounts

37. In Canada's view, Article 27.4's prohibition that a developing country Member "shall not increase the level of its export subsidies" refers to the level of expenditures, not to the level of budgetary appropriations. In support of the Panel's finding that actual expenditures should be used for the purposes of this measurement, Canada argues first of all that the *SCM Agreement* as a whole, and Article 1 of that Agreement in particular, is phrased in terms of transfers of value, such as when payments are made. The text of footnote 55 refers to "the level of export subsidies *granted*". (emphasis added) It does not refer to the level of export subsidies "budgeted". Moreover, where disciplines have been imposed on subsidies elsewhere in the *WTO Agreement*, the disciplines are based on expenditure levels.

38. Canada then argues that interpreting "level of ... export subsidies" to mean expenditures is consistent with the object and purpose of the *SCM Agreement*, which is "to reduce the economic distortions caused by subsidies." Such distortions are caused by actual expenditures of export subsidies, not by budgeting or planning for subsidies.

39. Canada notes that certain "absurdities" result from Brazil's argument that the "level of its export subsidies" should be based on budgetary amounts. First, a developing country could have

budgeted a large amount of export subsidies in 1994 without actually spending them, in order to expand its actual expenditures of export subsidies in later years. Second, it could create a situation where a developing country Member that does not *grant* export subsidies could lose the protection provided by Article 27 if it *budgets* for export subsidies at a level higher than its 1994 calendar year baseline. Conversely, a Member that maintains its budget at its previous level, but overspends on actual expenditures, would not be in breach of this condition.

40. With respect to Brazil's alternative definition of "grant" as "agree to, promise, undertake", Canada agrees with the Panel's finding that, in this context, this suggested definition is "inapposite".²⁷ Brazil's argument that it "grants" PROEX subsidies when they are appropriated in the budget is inconsistent with Brazil's argument on the timing of a subsidy, in which Brazil claims that the PROEX subsidy is granted by the letter of commitment and not by the issuance of the bonds. In addition, Brazil's argument is incorrect because a subsidy cannot be said to have been "granted" when neither a beneficiary nor an amount have been identified.

41. Finally, Canada maintains that Brazil's argument that its notification of subsidies under Article 25 is based on budgeted amounts is irrelevant. The purpose of Article 25 is quite different from Article 27.4. Article 27.4 provides a limited and conditional exception to the prohibition on export subsidies if developing country Members place a ceiling on their overall expenditures on export subsidies, whereas Article 25 requires Members to report all subsidies. Moreover, under Article 25, budgeted amounts are to be used in such notifications only where it is not possible to notify on a per unit basis.

(b) When Are PROEX Subsidies "Granted"?

42. Canada argues that the Panel correctly found that the issuance of bonds, as opposed to the letter of commitment, is the point at which a subsidy occurs under PROEX. This issue is really about effective implementation of the *SCM Agreement*. If the PROEX subsidy is found to be granted when letters of commitment are issued, Brazil can "lock in" the conditional commitments it has made, as well as any it is continuing to make, with respect to the letters of commitment. That is, if it is the letter of commitment that results in a "grant", all existing letters of commitment, i.e., those that have already been issued, will be consistent with WTO rules.

43. Canada submits that Brazil's argument is not consistent with the ordinary meaning of "potential direct transfer of funds" in Article 1.1(a)(1)(i) in the light of its context and object and purpose. Looking at the context of the provision demonstrates that the Panel was correct that

²⁷Panel Report, footnote 220.

"potential direct transfer of funds" refers only to loan guarantees or to similar measures. Under Article 1.1 of the *SCM Agreement* a "financial contribution" can exist only if the measure in question is capable of conferring a "benefit". The example of a "potential direct transfer of funds" provided in Article 1.1 – loan guarantees – re-inforces this interpretation. Loan guarantees are capable of being paid out in the future in the event of default by the debtor, but they confer a benefit even if they are not. Thus, to be considered a "potential direct transfer of funds", a government practice must be capable of becoming a payment, and confer a "benefit", *even if no payment is made*.

44. Canada argues that the letter of commitment is incapable of conferring a "benefit" in and of itself. A commitment is entered into before a sale even occurs. It becomes "binding" only when certain conditions are met. No money is transferred unless there is an export delivery. Thus, the issuance of the letter of commitment itself does not confer a "benefit". The letter of commitment only anticipates possible future benefits if subsidies are actually granted. Until an actual delivery is made, and bonds are consequently issued, no "benefit" can be said to exist.

45. Canada maintains that additional context for this conclusion is provided by the absence of the word "potential" in any of the other examples of "financial contributions" provided in Article 1.1. This omission is evidence that the drafters did not intend that "potential direct transfer of funds" should cover every promise to provide a "financial contribution" in the future. Rather, it should be restricted to the meaning elucidated by the example of loan guarantees.

46. Canada argues, furthermore, that if Brazil's argument is accepted, the result will simply be that Brazil will be in violation of its Article 3 obligations at an earlier date. Canada explains that it submitted evidence showing that if the letter of commitment were to be used as the point at which the subsidy occurs, Brazil would not have been in compliance, since 1996, with its obligation in Article 27.4 not to increase the level of its subsidies.

47. Canada notes Brazil's argument that any economic distortion occurs at the time the letter of commitment is issued. Canada responds by pointing out that, from the standpoint of *reducing* economic distortion, it is more effective to define the subsidy as the issuance of bonds. If the subsidy is defined as the issuance of a letter of commitment, then the result will be greater trade distortions, because the continued issuance of PROEX bonds under existing letters of commitment will result in many more subsidized aircraft being built in Brazil. In response to Brazil's argument that, under Brazilian law, it is legally liable for damages if it does not uphold a letter of commitment, Canada responds by stating that Members may not "contract out" of their WTO obligations.

48. In response to the European Communities' argument that subsidies should be deemed "granted" when a sales contract is signed, Canada responds that even after a contract is signed, bonds will not be issued if the aircraft is not delivered and exported.

4. Recommendation of the Panel

49. Canada notes Brazil's argument that the Panel's recommendation for the time period for withdrawal of the subsidy should be extended from 90 days to seven and one-half months.

50. In reply, Canada states that Article 4.7 of the *SCM Agreement* instructs panels, whenever subsidies are found to be prohibited, to require that such subsidies be withdrawn "without delay." Unlike Article 21.3(c) of the DSU, this requirement is not qualified in any way. The difference in the language between the two provisions makes clear that Article 21.3(c) of the DSU is not the benchmark for determining the period for withdrawing prohibited subsidies in this case.

51. Canada notes also that Article 4.12 of the *SCM Agreement* is only applicable with respect to time-limits for the purposes of the "conduct of ... disputes." However, Article 4.12 refers to only *disputes*, not to the period of *implementation*, which is fundamentally different from the periods for the conduct of disputes. Accordingly, Article 4.12 is of no value in interpreting withdrawal of subsidies "without delay", which is relevant only to implementation.

52. Canada argues that Article 7.9 of the *SCM Agreement* provides that countermeasures may be imposed if actionable subsidies are not withdrawn within six months of the adoption of the panel or Appellate Body report. It is logical that where a subsidy is required to be withdrawn "without delay", the timeframe for withdrawal must be shorter than the six month period provided under Article 7.9 and in no circumstances should be longer than six months.

53. Canada asks the Appellate Body to recommend that PROEX export subsidies be withdrawn without delay as of the date of adoption of the Panel and Appellate Body Reports, because Brazil is continuing to grant new subsidies and maintain old subsidies, and is intensifying efforts to enter into long-term subsidization commitments before the end of the implementation period.

54. Finally, Canada recalls that its request for a three-month period for withdrawal was made in view of its analysis that "withdrawal" meant stopping the payments of bonds paid in semi-annual instalments. Canada notes that if Brazil does not need to effect a legislative or regulatory change to stop these payments, withdrawal could come even faster.

C. *Claims of Error by Canada – Appellant*

1. Burden of Proof Under Article 27.4 of the *SCM Agreement*

55. Canada is appealing the issue of the proper allocation of the burden of proof under Article 27.4 of the *SCM Agreement* even though the finding did not affect the outcome of the case. Article 27.4 is an "exception" to Article 3, and therefore Brazil, as the party invoking the "exception", has the burden of proof. The Panel's conclusion that Article 27 is not an exception was based on the fact that Article 27 is phrased as "[t]he prohibition of [Article 3.1(a)] ... shall not apply to" Article 27 should not be considered an element of a claim of violation of Article 3.1(a), as opposed to an affirmative defense or exception, simply because the words "exception" or "exemption" were not explicitly used in Article 27. Rather, like Article XX of the GATT 1994, Article 27.2 contains an exception to the obligations of Article 3.1(a). Therefore, the burden of proof is on the party invoking Article 27. Although the words "exception" or "exemption" are not explicitly used in Article 27, Canada asserts that it should be regarded as an affirmative defence, not an element in a claim of violation of Article 3.1(a).

2. Has Brazil Increased the Level of its Export Subsidies?

(a) Constant or Nominal Dollars

56. Canada argues that the Panel's finding that it is appropriate in this case to use constant dollars in order to provide a more meaningful assessment of whether Brazil has increased the level of its export subsidies is "unreasoned" and does not respect the text, context and the object and purpose of the *SCM Agreement*.

57. Canada submits that there is no explicit provision for conversion of the level of export subsidies to a constant value either in Article 27.4 or in footnote 55. Moreover, paragraph 5 of Annex IV of the *SCM Agreement* specifically provides for inflation adjustment. Thus, the fact that the drafters did not provide for inflation adjustment in Article 27 gives rise to the "commonplace inference" that they did not intend for inflation to be taken into account in this provision. Indeed, there is no guidance in the Agreement on how indexation should be accomplished if it were to be used.

58. In the alternative, Canada argues that the one provision in the *SCM Agreement* where indexation is used – paragraph 5 of Annex IV – only applies if the amounts would be significantly affected by inflation. Canada notes that a large part of Brazil's trade takes place in U.S. dollars, that PROEX bonds are indexed to U.S. dollars, and that the PROEX budget and expenditures are notified to the WTO in U.S. dollars. Given that Brazil expressed its export subsidies in the currency of a

non-inflationary economy, and, therefore, inflation could not have had a significant effect, in Canada's view, there is no basis for the Panel's conclusion that constant dollars provide a more "meaningful assessment" as to whether Brazil has increased the level of its export subsidies.

3. Conditional Appeal: "Maintaining" Subsidies Under Article 3.2 of the *SCM Agreement*

59. In its appellant's submission, Canada argues that if the Appellate Body reverses the Panel's finding that subsidies are "granted" at the time bonds are issued, not when the letter of commitment is issued, the Appellate Body should then complete the legal analysis, relying on the factual record before the Panel. To this end, the Appellate Body should find that subsequent issuance of PROEX bonds upon the delivery of the subject aircraft is inconsistent with Brazil's obligation not to "maintain" prohibited export subsidies under Article 3.2 of the Agreement.

60. Canada notes the overall importance of this issue by quoting the Panel's statement that if there were no prospective discipline for the provision of subsidies, "the SCM Agreement's prohibitions could not be invoked until a particular prohibited subsidy had actually been paid."²⁸ If the Appellate Body does not give proper meaning to the word "maintain" in Article 3.2, the *SCM Agreement* will be rendered ineffective because Brazil will be free to provide prohibited export subsidies for many years after the deadline for implementation of the report, as long as the letter of commitment was provided before the report was adopted. For the same reason, the eight-year phase out period in Article 27.4 will be extended indefinitely.

61. Canada notes that the plain meaning of "maintain" is "go on with, continue, persevere in; preserve or retain; cause to continue". The issuance of the PROEX bonds causes the PROEX subsidy to continue to exist, and consequently preserves that subsidy, and, therefore, "maintains" a prohibited subsidy within the meaning of Article 3.2 of the *SCM Agreement*. In the context of Article 27, this interpretation would lead to the commitment to issue PROEX bonds extending past the end of the eight-year phase out period, and, therefore, "maintain" a prohibited export subsidy beyond the phase out deadline.

²⁸Panel Report, footnote 187.

D. *Arguments by Brazil – Appellee*

1. Burden of Proof Under Article 27.4 of the *SCM Agreement*

62. In Brazil's view, the Panel correctly disagreed with Canada's argument that the temporary exemption provided for developing countries in Article 27.2 is the legal equivalent of the permanent exception from *GATT 1994* obligations for all Members provided by Article XX of *GATT 1994*.

63. Brazil argues that Article 27, entitled "Special and Differential Treatment of Developing Country Members", is in no way subordinate to Article 3 or any other article of the *SCM Agreement*, nor is it to be narrowly interpreted in favor of any other provision. Rather, Article 27 is a transitional arrangement with its own terms. In Brazil's view, the temporary legitimacy of developing country Member's export subsidies is presumed unless it is proven that a particular Member is not in compliance with its obligations under Article 27.

64. In Brazil's view, if Article 27 is read in the order in which its terms are set out, the meaning is clear. Article 27.2 begins: "Article 3 shall not apply". For Article 3 to apply, the burden of proof must reside with the complainant to demonstrate that the conditions of Article 27 are not met, and Article 3 therefore does apply. Otherwise, Article 3 always would apply, subject only to the ability of a developing country Member to bear the burden of proof under Article 27. The fact that non-application depends upon compliance with Article 27.4 does not alter the ordinary meaning of "shall not apply". A *seriatim* reading of Article 27 first establishes that Article 3 does not apply, and only then reaches the "subject to compliance" clause in Article 27.2(b).

65. Brazil further argues that both the context and the object and purpose of Article 27 support the Panel's conclusion. The context is provided by the title, "Special and Differential Treatment of Developing Country Members". This title is indicative of the nature of the provision, and expresses a concern for the well-being of developing country Members. Thus, a high degree of liberality in interpretation of this provision is required. Similarly, the object and purpose is stated in the first paragraph of Article 27, which reads: "Members recognize that subsidies may play an important role in economic development programmes of developing country Members." According to Brazil, Canada's arguments placing the burden of proof under Article 27 on developing country Members ignore the context and the object and purpose.

66. Brazil notes two final points. First, placing the burden of proof on a complaining party would *not* mean that potential complainants would be frustrated by a lack of information. Information of this nature is available in the panel proceedings and through Article 25 subsidy notifications. In this case, Brazil has provided information through both avenues. Second, Article 27.7 of the

SCM Agreement provides that a Member adversely affected by export subsidies has an additional avenue for a complaint under the provisions of Article 7 of that Agreement.

2. Has Brazil Increased the Level of its Export Subsidies?

(a) Constant or Nominal Dollars

67. Brazil notes that Canada appeals the Panel's decision to use constant dollars to measure the level of increase in export subsidies, on two grounds: 1) the Panel confined its conclusion to "this case"; and 2) use of a constant measure of value is contrary to the ordinary meaning of the phrase "level of ... export subsidies".

68. In Brazil's view, the Panel's confining of its conclusion to the facts of this case is a proper, prudent exercise of judicial economy. The Panel had to decide only this case, not another case, and there is nothing irreversible in the Panel's approach.

69. Brazil notes Canada's argument that because Article 27.4 does not explicitly require the use of constant value, panels are prohibited from using that measure. Brazil draws the opposite conclusion from the terms of Article 27.4: since Article 27.4 does not prohibit the use of constant value, nothing in the *SCM Agreement* precludes the Panel's conclusion.

70. Brazil argues further that the use of a constant measure is required if the special rules for developing countries in Article 27 are to be given genuine meaning. The Appellate Body may take "judicial notice" that currencies tend to depreciate over time because of inflationary pressures, and these pressures are greatest in developing countries. A failure to adjust the level of export subsidies for inflation would effectively repeal the Article 27 "exemption". Brazil explains that the fact that Brazil reported its subsidies in dollars means that the inflation rate was smaller than it otherwise would have been, but inflation was present nevertheless, and the Panel properly allowed for it.

3. Conditional Appeal: "Maintaining" Subsidies Under Article 3.2 of the *SCM Agreement*

71. Brazil notes Canada's argument that if the Appellate Body reverses the Panel and finds that the subsidy occurs at the point the letter of commitment is issued, then it should make an additional finding that the issuance of the NTN-I bonds constitutes "maintaining" a subsidy under Article 3.2. Brazil agrees with Canada that "maintain" is defined as "go on with, continue, persevere in; preserve or retain; cause to continue". However, what must not be "maintained" under the *SCM Agreement* are "subsidies," a term Brazil claims that Canada defines in the *Canada – Aircraft* appellate proceeding as the equivalent of "subsidy programme". Thus, it is simply the subsidy programme itself, in this case PROEX, which must not be "maintained".

72. Brazil first notes that the word "maintain" logically applies only to subsidies granted prior to the effective date of the WTO, 1 January 1995. If subsidies were granted before that date, they would be consistent with the requirements of Article 3.2 of the *SCM Agreement* if that paragraph did not prohibit the maintenance of such subsidies.

73. Brazil argues that, in this case, the "subsidy" occurs when the letter of commitment is issued. The subsequent issuance of the bonds is no more the maintenance of a subsidy than is the subsequent payment received by redeeming the bonds over the life of the financing. The only way the PROEX subsidy would be "maintained" is if Brazil did not withdraw the subsidy element of the programme in the event of adoption of a report finding PROEX to be inconsistent with Brazil's WTO obligations. By contrast, it would not be "maintaining" the PROEX subsidy if it eliminated PROEX and simply continued to honour contractual obligations made before the elimination of the programme.

74. Brazil refers to Canada's argument that this interpretation allows Members to "contract out" of their obligations. In response, Brazil contends that, to the extent that this is true, it is true of virtually any subsidy that is subsequently determined to be inconsistent with WTO obligations. For example, a finding that a low-interest loan is a subsidy would not require the borrower to agree to less favourable terms. It simply requires that no new low-interest loans be granted.

75. Brazil notes that subsidy programmes often utilize payments made over a long period. Indeed, Canada's most recent subsidy notification under Article 25 demonstrates that it has made payments under certain programmes after the termination of the programme. In Brazil's view, the honouring of prior subsidy commitments cannot constitute "maintaining" export subsidies under Article 3.2 of the *SCM Agreement*.

E. *Arguments by Third Participants*

1. European Communities

(a) "Material Advantage" Clause of Item (k) of the Illustrative List of Export Subsidies

76. The European Communities disagrees with the Panel's interpretation of the "material advantage" clause in item (k) of the Illustrative List. In the European Communities' view, this clause allows Members to "match" the export credits granted by other Members, even if the rates provided are less than commercial rates. The second paragraph of item (k) explicitly permits certain export credit practices under conditions which conform to the *OECD Arrangement*. The *OECD Arrangement* authorizes participants to apply interest rates lower than the designated minimum interest rate, the Commercial Interest Reference Rate (the "CIRR"), in order to "match" the

rates applied by other participants or by non-participants in the Arrangement. The level at which the minimum interest rates, as well as the "matching" mechanism, are set, demonstrates that the purpose of the *OECD Arrangement* is to ensure that export credits do not distort competition, rather than to ensure that export credits are always offered at "commercial rates". The European Communities believes that the second paragraph of item (k) provides context for the "material advantage" clause in the first paragraph of item (k), and that this clause in the first paragraph serves the same purpose as the second paragraph.

77. The European Communities then argues that footnote 5 to Article 3.1(a) of the *SCM Agreement* does not include *a contrario* inferences. On the contrary, footnote 5 requires an "affirmative statement" in the Illustrative List to the effect that a measure does not constitute an export subsidy. The second paragraph of item (k) provides an example of such an "affirmative statement"; this paragraph describes the type of measure to which footnote 5 refers as "not constituting export subsidies". By contrast, the language of the "material advantage" clause in the first paragraph of item (k) does not constitute such an "affirmative statement". The "material advantage" clause simply defines the scope of the prohibition in the first paragraph of item (k). Therefore, the European Communities concludes that the "material advantage" clause is not an example of the type of measure to which footnote 5 refers.

78. The European Communities disagrees with the United States position that the Panel made an "alternative finding" related to the "material advantage" clause. What the United States calls a "finding" is in reality merely an "interpretation". The difficulty arises because the Panel has treated Brazil's argument for an exception under item (k) as an affirmative defence. In fact, item (k) is in the nature of a prohibition. Thus, according to the European Communities, the Panel's decision to place the burden of proof on Brazil was in error.

(b) Has Brazil Increased the Level of its Export Subsidies?

(i) Actual Expenditures or Budgeted Amounts

79. The European Communities agrees with the Panel's finding that actual expenditures should be used to determine whether there is an increase in the "level of ... export subsidies" under Article 27.4. Footnote 55 of the *SCM Agreement* indicates that the relevant "level of ... export subsidies" is that of the subsidies "granted". Authorization given by the budgetary authority of a Member to the executive to spend funds does not create any rights for the potential beneficiaries of the fund. Therefore, in the European Communities' view, the PROEX payments may not be deemed "granted" until the sales contracts are concluded.

(ii) When are PROEX Subsidies "Granted"

80. According to the European Communities, PROEX payments should be deemed "granted" when a definitive purchase contract (i.e., not a simple option contract) is signed by Embraer and the foreign purchaser. The European Communities agrees with the Panel that the issuance of a letter of commitment is not sufficient to consider that the subsidy has been "granted", since the obligation to issue the bonds is conditional upon the conclusion of a sales contract. Each of the parties is free to sign or not to sign the contract after the letter of commitment has been issued, and in at least some cases letters of commitment are issued with respect to option contracts. The benefit to Embraer occurs upon concluding a sales contract.

81. The European Communities maintains that if the PROEX payments are deemed "granted" by the Appellate Body when the aircraft is physically exported, all bond issues will be prohibited in the future by virtue of the Appellate Body ruling. As a result, bonds may not be issued even under those existing sale contracts for which export has not yet occurred. This would be "extremely disruptive" of the rights of private parties under sales contracts that have already been concluded and are legally enforceable. Furthermore, any harm caused by the subsidy occurs at the moment when the sales contract is signed.

82. The European Communities notes that the United States made a similar argument in *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*²⁹, where the United States claimed that a contract between the Government of Australia and a private party to provide a grant constituted a "subsidy" within the meaning of Article 1 of the *SCM Agreement*.

(c) Recommendation of the Panel

83. The European Communities does not express any views on whether the 90-day period for withdrawal of PROEX subsidies set by the Panel is appropriate, particularly given the Panel's failure to advance specific reasoning for its conclusion. However, the European Communities considers that Brazil's rationale for applying a seven and one-half month period is incorrect. A period of seven and one-half months could under no circumstances qualify as implementation "without delay." Moreover, the use of the 15 month period referred to in Article 21.3(c) is inappropriate as a guideline.

84. The European Communities notes that Article 4.12 only applies with respect to time-periods for the "conduct of ... disputes". The implementation of a panel report, however, is not part of the "conduct" of a dispute.

²⁹Adopted 16 June 1999, WT/DS126/R, para. 7.43.

85. The European Communities attaches great importance to the principle in Article 3.2 of the DSU that no retroactive remedies may be imposed.

(d) Conditional Appeal: "Maintaining" Subsidies Under Article 3.2 of the *SCM Agreement*

86. With respect to Canada's argument that the continued issuance of bonds violates the prohibitions in Article 3.2 on "maintaining" export subsidies, the European Communities notes briefly that Canada's position is incompatible with the principle that the DSB's rulings and recommendations are not retroactive. If Canada's argument were accepted, it would require Members to recover subsidies that have already been "granted". The obligation not to "maintain" prohibited subsidies is intended to address the situation where a Member grants prohibited subsidies within the framework of a specific programme. Article 3.2 simply requires that this programme not be "maintained", that is, it must be abolished.

2. United States

(a) Burden of Proof Under Article 27.4 of the *SCM Agreement*

87. The United States notes that it agrees with the arguments made by Canada that the burden of proof under Article 27 is on the developing country Member to show that it is in compliance with the provisions of Article 27.4.

(b) Are PROEX Interest Rate Equalization Payments Used "To Secure a Material Advantage in the Field of Export Credit Terms"?

88. The United States notes two separate findings by the Panel on the "material advantage" clause in item (k) of the Illustrative List. First, the Panel found that an item (k) payment is "used to secure a material advantage" where the payment makes available export credit on terms more favourable than otherwise available in the marketplace. Second, the Panel made an alternative finding based on the assumption that Brazil was correct in its assertion that the "material advantage" clause required an examination of export credit terms available with respect to competing products exported from other Members. In this alternative finding, the Panel found that the field of export credit terms is limited to interest rates, grace periods, transaction costs, maturities and the like, and does not encompass the price at which the product is sold.³⁰ The United States argues that the Panel's first finding was incorrect as a matter of law, but that the Panel's alternative finding was correct and should be upheld by the Appellate Body.

³⁰Panel Report, para. 7.28.

89. According to the United States, the Panel's first finding reads the "material advantage" clause out of item (k). The United States states that, under this first finding by the Panel, any payment by a government of costs incurred by exporters or financial institutions in obtaining credits necessarily results in "terms which are more favourable than would otherwise be available" in the marketplace, and, therefore, any advantage becomes a "material advantage".

90. In addition, the United States argues, by adopting an interpretation that renders the "material advantage" clause meaningless, the Panel's first finding ignores the fact that, in addition to listing practices that *do* constitute prohibited export subsidies, the Illustrative List also lists some practices that *do not* constitute prohibited export subsidies. The intent of the drafters in using the term "illustrative" was to signify that not all types of potential export subsidy practices are addressed by the Illustrative List. However, where an item of the Illustrative List does address a particular type of practice, that item sets forth the standard for determining whether that practice is, or is not, a prohibited export subsidy. Thus, when item (k) provides that export credits constitute prohibited export subsidies "in so far as they are used to secure a material advantage in the field of export credit terms", item (k), by necessary implication, also provides, *a contrario*, that export credits do not constitute prohibited export subsidies if they are not "used to secure a material advantage in the field of export credit terms".

91. The United States argues that the Panel's alternative finding was correct. According to the United States, a Member would not "secure a material advantage" if it merely "matched" export credits offered by another Member. Here, however, a different set of facts occurred. Here, the Panel properly rejected Brazil's argument for a comparison of Brazil's export credit terms to Canada's non-export credit subsidies, by limiting the "field of export credit terms" to "items directly related to export credits, such as interest rates, grace periods, transaction costs, maturities and the like."³¹

92. The United States concludes that because Brazil does not appear to have demonstrated, or even claimed, that PROEX financing is intended to match "export credit terms" under the standard adopted by the Panel in its alternative finding, the Appellate Body should uphold the Panel's alternative finding.

³¹Panel Report, para. 7.28.

(c) Has Brazil Increased the Level of its Export Subsidies?

(i) Actual Expenditures or Budgeted Amounts

93. The United States notes that Brazil's appeal focuses on "dueling dictionary definitions" of the verb "to grant", arguing that the term also means "[a]gree to, promise, undertake". Brazil argues that because budgeted amounts are appropriate for Article 25, they are therefore appropriate for Article 27 as well.

94. In the view of the United States, Article 25 establishes exactly the opposite. Clause (ii) contemplates three methods of measuring subsidies. Budgeted subsidies is the third method listed in Article 25, and that method is only to be used in cases where the other two methods are not possible. The preferred method, subsidy per unit, contemplates the use of actual subsidies, which leads to a reasonable inference that the use of actual expenditures is the normal rule for purposes of the *SCM Agreement*.

(ii) Constant or Nominal Dollars

95. The United States agrees with Canada that the use of constant dollars was not the appropriate means of determining whether Brazil had increased the "level of its subsidies" under Article 27.4 – with one exception. The United States disagrees with Canada's reliance on the reference to inflation adjustments in paragraph 5 of Article IV of the *SCM Agreement* as evidence that the drafters intended to preclude the consideration of inflation in all other instances. The fact that the drafters of the *SCM Agreement* referenced an inflation adjustment in Annex IV does not necessarily mean that they intended to preclude a consideration of inflation for all other purposes. A more likely explanation is that the drafters did not consider the issue in other contexts.

96. The United States raises a concern that the application of an all-purpose, undefined inflation adjustment for purposes of assessing a Member's compliance with its commitments would add a considerable element of uncertainty to the rights and obligations of Members, because a Member's compliance or non-compliance could depend entirely upon the particular deflator chosen by a dispute settlement panel. As a result, the proper interpretation of Article 27.4 is that the level of export subsidies should be assessed in nominal, rather than constant, terms.

(d) Recommendation of the Panel

97. The United States disagrees with Brazil that the requirement in Article 4.12 that the time periods in the DSU be halved applies in the context of withdrawal of subsidies. Under Brazil's argument, the time period for withdrawal of the subsidy should be seven and one-half months, or one half the 15 months provided in Article 21.3(c). The United States agrees with the Panel's rejection of

the Brazilian argument, for two reasons. First, Article 4.12 applies "except for time-periods specifically prescribed in [Article 4]". However, a time period for implementation *is* specifically prescribed in Article 4.7, namely, the time-period to be specified by the panel. Second, under the DSU, there is no set time period for implementation that can be halved under Article 4.12. The 15 months referred to in Article 21.3(c) is "only a guideline", and is only relevant if immediate compliance is impracticable.

(e) Conditional Appeal: "Maintaining" Subsidies Under Article 3.2 of the *SCM Agreement*

98. The United States agrees with Canada that if the Appellate Body finds that the letter of commitment is the point at which the subsidy occurs, it should also find that the issuance of PROEX bonds pursuant to existing letters of commitment is inconsistent with the prohibition in Article 3.2 that Members shall not "maintain" export subsidies. The United States then offers the following additional observations.

99. The United States disagrees with what it considers Brazil's "implicit" position that a subsidy comes into, and goes out of, existence simultaneously at the moment of its granting. It is well-accepted that the timing and duration of a subsidy are two different things, and that a subsidy can have a duration that extends over a period of years. When a subsidy is properly allocated over a period of several years, the withdrawal of that portion of the subsidy allocated to future time periods would not constitute a retroactive remedy. Rather, it would constitute prospective implementation based on a recognition of the distinction between the measure conferring a subsidy and the subsidy itself.

100. The United States rejects the argument of Brazil that issuance of new bonds under existing letters of commitment cannot be stopped because it would be disruptive to private parties. Virtually all WTO dispute settlement rulings will cause disruption to private parties. The United States refers to the Award of the Arbitrator in *Indonesia – Certain Measures Affecting the Automobile Industry* ("*Indonesia – Automobiles*"),³² which notes that some degree of adjustment by the domestic industry occurs in response to every ruling.

101. The United States further notes that the European Communities, which supported Brazil's argument on this point at the Panel stage, took a "contradictory" position in the panel report in *Indonesia – Automobiles*.³³ In that case, the European Communities argued that the "withdrawal" of a subsidy could entail the recovery by the subsidizing government of previously bestowed subsidies.

³²Award of the Arbitrator, WT/DS54/15, WT/DS55/14, WT/DS59/13, WT/DS64/12, 7 December 1998, para. 23.

³³Adopted 23 July 1998, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, paras. 5.276-5.278.

102. The United States contends that Canada's argument that Brazil must not pay out additional prohibited subsidies in the form of PROEX bonds is correct, and is consistent with the *SCM Agreement* and the DSU. Otherwise, dispute settlement would be largely useless as a tool for addressing distortive subsidies. Regardless of whether the letter of commitment or the issuance of a bond constitutes the PROEX subsidy, the appropriate outcome is that Brazil must refrain from issuing new bonds and withdraw the subsidy.

III. Preliminary Procedural Matter and Ruling

A. *Procedures Governing Business Confidential Information*

103. By joint letter of 27 May 1999, Brazil and Canada requested that we apply, *mutatis mutandis*, the Procedures Governing Business Confidential Information adopted by the Panel in this case (the "BCI Procedures"). In their request, they also asked that certain of the BCI Procedures be applied to the third participants in this appeal; in particular, that the third participants designate authorized representatives who would be required to file declarations of non-disclosure with the Presiding Member of this Division before being allowed to view any information designated as "business confidential" or to attend portions of the oral hearing when such information may be discussed.

104. By letter of 31 May 1999, we invited the participants to file legal memoranda in support of their request, and offered each an opportunity to respond to the legal memorandum submitted by the other. The third participants were also given an opportunity to file legal memoranda. Brazil and Canada submitted legal memoranda on 2 June 1999. On 4 June 1999, the third participants, the European Communities and the United States, also filed legal memoranda. On the same date, Brazil and Canada each filed a written response to the memorandum previously submitted by the other on 2 June 1999. A preliminary hearing on this issue was held on 10 June 1999, with this Division sitting jointly with the Division of the Appellate Body hearing the appeal in *Canada – Aircraft*.³⁴

1. Arguments of Participants and Third Participants

(a) Canada

105. Canada considers that Article 18.2 of the DSU does not provide adequate procedural protection for confidential proprietary business information of the type that is before the Appellate Body in this case. This information is not in the public domain and would be of significant commercial interest, particularly to competitors of the enterprises that it concerns.

³⁴*Supra*, footnote 16.

106. Canada observes that, in the absence of procedures to protect business confidential information at the appellate review stage, Brazil made references in its other appellant's submission and in its appellee's submission to business confidential information that Canada had submitted to the Panel under the BCI Procedures. The information submitted by Brazil was not, therefore, subject to any procedures to protect its confidentiality. Canada also argues that the Appellate Body should adopt procedures to ensure that the questions it poses at the oral hearing can be given a complete response, where necessary by reference to business confidential information included in the panel record.

107. In adopting procedures for protecting business confidential information, Canada submits that the Appellate Body must balance two competing interests, both rooted in fairness and due process, and neither having a claim to better protection than the other. First, both the Appellate Body and the participants must be given reasonable access to the information that was introduced into evidence before the Panel. Second, however, additional procedural safeguards are necessary to provide private business interests with adequate protection for their proprietary business information when Canada or Brazil deems it necessary to refer to such evidence in support of its case. Canada, therefore, requests that, pursuant to Rule 16(1) of the *Working Procedures*, the Appellate Body adopt, *mutatis mutandis*, the Panel's BCI procedures and the "Declaration of Non-Disclosure" set out in Annexes I and II of the Panel Report.

(b) Brazil

108. Brazil states that it agreed to join in Canada's request that the Appellate Body adopt procedures for protecting business confidential information as a good faith attempt to accommodate Canada's concerns on confidentiality. Brazil notes two qualifications to its acceptance in principle of the BCI Procedures by the Appellate Body. First, the procedures should not unduly restrict the access of authorized persons to the information. Second, the procedures must be limited to business proprietary information of private parties who are not subject to the confidentiality obligations of the DSU.

109. Brazil recalls that in its submissions to the Appellate Body, it cited certain information that Canada had designated before the Panel as business confidential information. Brazil does not consider that this particular information is, in any sense, business confidential information entitled to special protection.

110. Brazil emphasizes that, in including certain information Canada had designated as "business confidential" before the Panel, in its submissions to the Appellate Body, and in serving those submissions on Canada and on the third participants in this appeal, it did not act inconsistently with

either the letter or the spirit of the DSU. Brazil notes that Rule 18(2) of the *Working Procedures* required it to serve its written submissions on Canada as well as the third participants, and Brazil states that it "has no reason to doubt" that the third participants will comply with their obligations under Article VII:1 of the *Rules of Conduct for the Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "*Rules of Conduct*"). Brazil maintains as well that the confidentiality provisions of Article 18.2 of the DSU also apply to the third participants.

(c) European Communities

111. The European Communities considers that the BCI Procedures are based on the administrative protective order system used in countervailing duty procedures before the administrative authorities of certain Members of the WTO. This system cannot simply be transplanted into the WTO.

112. The European Communities contends that the proposed procedures for protecting business confidential information are inconsistent with the DSU in two ways. First, the proposed procedures deprive Members of rights contained in the DSU. They are inconsistent with Article 18.1 of the DSU, which forbids *ex parte* communications with a panel or the Appellate Body. In the case of the Appellate Body, the prohibition against *ex parte* communications also extends to third participants under Rule 19(1) of the *Working Procedures*. Such procedures would deny a party to a dispute access to business confidential information if that party could not accept the procedures for protecting business confidential information developed by the panel or the Appellate Body Division. The proposed procedures for protecting business confidential information are also inconsistent with Rule 18(2) of the *Working Procedures*, which requires "every document" filed by a participant or a third participant to be served on the other participants and third participants.

113. Second, the proposed procedures would impose new obligations on Members and create new rights for Members, contrary to Article 3.2 of the DSU. Such additional procedures would restrict access to certain documents to defined places, thereby restricting a party's ability to consider them. They would require the receiving party to permit the providing party to inspect the safe in its Mission where the information is to be stored. The European Communities argues that this is "tantamount to a waiver of the immunity enjoyed by those premises under international law". In addition, the procedures would require officials of the European Communities to sign undertakings incompatible with the "conduct of their duties".

114. The European Communities submits that Articles 14 and 18.2 of the DSU regulate the question of confidentiality in dispute settlement proceedings. If information is designated as confidential by a party to a dispute, Article 18.2 requires the other parties to take all necessary

precautions according to their own administrative traditions and structures. The "bad faith" of other Members cannot be presumed. The proper place to resolve problems posed by the treatment of confidential information is in the current review of the DSU by WTO Members.

(d) United States

115. The United States argues that the need for additional procedures for protecting business confidential information is *extremely important*, "because it goes to the viability of WTO dispute settlement as a vehicle for preserving the rights and obligations of Members". In the view of the United States, "basic considerations of due process, as well as the need to preserve rights and obligations of Members, require the Appellate Body to apply such procedures". As a consequence, the United States has no objection to the joint request made by Brazil and Canada.

116. The United States makes three general arguments in support of the use of additional procedures for protecting business confidential information in WTO dispute settlement proceedings. First, the United States argues that nothing in the DSU precludes panels or the Appellate Body from adopting additional procedures for protecting business confidential information. On the contrary, Article 12.1 of the DSU explicitly allows panels to deviate from the working procedures set out in Appendix 3 of the DSU. The United States believes that the Appellate Body has authority comparable to that of panels to adopt such procedures as a result of Article 17.9 of the DSU and Article 16(1) of the *Working Procedures*.

117. Second, the United States argues that the application of procedures for protecting business confidential information promotes important objectives because Members' rights and obligations under the covered agreements can only be preserved if due process is accorded to both the complaining party and the responding party. The United States maintains that the demands of due process are not satisfied, however, if the absence of such procedures precludes a Member from properly making its case.

118. Third, the United States maintains, contrary to the position taken by the European Communities, that a Member's national laws do not provide a basis for depriving another Member of its rights under the *WTO Agreement*. Thus, the United States asserts, the claim by the European Communities that its officials would be unable, under their staff regulations, to accept the undertakings proposed "should not be allowed".

2. Ruling and Reasons

119. In our preliminary ruling of 11 June 1999, we concluded that it is not necessary, under all the circumstances of this case, to adopt *additional* procedures to protect business confidential information in these appellate proceedings. Our ruling was as follows:

Pursuant to Article 17.9 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), the Appellate Body has the authority to draw up its own Working Procedures. Under Rule 16.1 of our *Working Procedures for Appellate Review*, a Division of the Appellate Body may adopt additional procedures for the orderly conduct of a particular appeal, provided that any such additional procedures are not inconsistent with the DSU, the other covered agreements and the *Working Procedures for Appellate Review*. We have concluded, however, that it is not necessary, under all the circumstances of this case, to adopt *additional* procedures to protect "business confidential information" during these appellate proceedings.

We note that, with respect to "business confidential information" submitted to the Panel that remains currently in the possession of the participants, Article XII of the Panel Procedures Governing Business Confidential Information required the parties, "[a]t the conclusion of the Panel", to "return any printed or binary-encoded Business Confidential information in their possession to the party that submitted such Business Confidential (sic)" and to "destroy all tapes and transcripts of the Panel hearings that contain Business Confidential information, unless the parties mutually agree otherwise." It thus appears that each participant has an obligation, under the Panel Procedures, to return any Business Confidential information submitted by the other participant. The WTO Secretariat, assisting the Panel, was required, by the Panel Procedures, to "transmit any printed or binary-encoded Business Confidential information, plus all tapes and transcripts of the panel hearings that contain Business Confidential Information, to the Appellate Body as part of the record of the Panel proceedings." That information will be kept in a secure, locked cabinet in the Appellate Body Secretariat.

We also note that *all* Members are obliged, by the provisions of the DSU, to treat these proceedings of the Appellate Body, including written submissions and other documents filed by the participants and the third participants, as confidential. We are confident that the participants and the third participants in this appeal will *fully respect* their obligations under the DSU, recognizing that a Member's obligation to maintain the confidentiality of these proceedings extends also to the individuals whom that Member selects to act as its representatives, counsel and consultants.

Accordingly, we decline the request of Brazil and Canada. The reasons for this ruling will be set out more fully in the Appellate Body Report in this appeal.

120. We have no further reasons to add to the first two paragraphs of our ruling above. The following is an elaboration of the reasons in the third paragraph of our ruling. Our ruling applies only to the request for *additional* procedures to protect "business confidential information" in these appellate proceedings, and it, therefore, has no effect on the BCI Procedures adopted by the Panel. Neither the Panel's decision to adopt BCI Procedures, nor the content of those Procedures, has been appealed.

121. With respect to appellate proceedings, in particular, the provisions of the DSU impose an obligation of confidentiality which applies to WTO Members generally as well as to Appellate Body Members and staff. In this respect, Article 17.10 of the DSU states, without qualification, that "[t]he *proceedings* of the Appellate Body *shall be confidential*." (emphasis added) The word "proceeding" has been defined as follows:

In a general sense, the form and manner of conducting juridical business before a court or judicial officer. Regular and orderly progress in form of law, *including all possible steps in an action from its commencement to the execution of judgment*.³⁵ (emphasis added)

More broadly, the word "proceedings" has been defined as "the business transacted by a court".³⁶ In its ordinary meaning, we take "proceedings" to include, in an appellate proceeding, any written submissions, legal memoranda, written responses to questions, and oral statements by the participants and the third participants; the conduct of the oral hearing before the Appellate Body, including any transcripts or tapes of that hearing; and the deliberations, the exchange of views and internal workings of the Appellate Body.

122. Article 18.2 of the DSU also contains rules protecting the confidentiality of written submissions and information submitted to the Appellate Body:

Written submissions to the panel or the Appellate Body shall be treated as confidential, but shall be made available to the parties to the dispute. Nothing in this Understanding shall preclude a party to a dispute from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted by another Member to the panel or the Appellate Body which that Member has designated as confidential. A party to a dispute shall also, upon request of a Member, provide a non-confidential summary of the information contained in its written submissions that could be disclosed to the public. (emphasis added)

³⁵*Black's Law Dictionary*, (West Publishing Co., 1990), p. 1204.

³⁶*The New Shorter Oxford English Dictionary*, (Clarendon Press, 1993), Vol. II, at 2364.

123. In our view, the provisions of Articles 17.10 and 18.2 apply to all Members of the WTO, and oblige them to maintain the confidentiality of any submissions or information submitted, or received, in an Appellate Body proceeding. Moreover, those provisions oblige Members to ensure that such confidentiality is fully respected by any person that a Member selects to act as its representative, counsel or consultant. In this respect, we note, with approval, the following statement made by the panel in *Indonesia – Automobiles*:

We would like to emphasize that *all members of parties' delegations -- whether or not they are government employees -- are present as representatives of their governments, and as such are subject to the provisions of the DSU and of the standard working procedures, including Articles 18.1 and 18.2 of the DSU and paragraphs 2 and 3 of those procedures.* In particular, parties are required to treat as confidential all submissions to the Panel and all information so designated by other Members; and, in addition, the Panel meets in closed session. Accordingly, *we expect that all delegations will fully respect those obligations and will treat these proceedings with the utmost circumspection and discretion.*³⁷ (emphasis added)

124. Finally, we wish to recall that Members of the Appellate Body and its staff are covered by Article VII:1 of the *Rules of Conduct*,³⁸ which provides:

Each covered person *shall at all times maintain the confidentiality of dispute settlement deliberations and proceedings together with any information identified by a party as confidential.* (emphasis added)

125. For these reasons, we do not consider that it is necessary, under all the circumstances of this case, to adopt *additional* procedures for the protection of business confidential information in these appellate proceedings. We, therefore, decline the request of Brazil and Canada.

IV. Issues Raised In This Appeal

126. The following issues are raised in this appeal:

- (a) whether the Panel erred in finding that certain regulatory instruments specified in the request for the establishment of a panel, but not discussed in the consultations, were properly before the Panel;

³⁷*Supra*, footnote 33.

³⁸The *Rules of Conduct* have been directly incorporated into the *Working Procedures* (see Rule 8 of those *Working Procedures*).

- (b) whether the Panel erred in finding that in a dispute involving a claim of violation of Article 3.1(a) of the *SCM Agreement* by a developing country Member, the complaining party has the burden of proving that the developing country Member in question has not acted in conformity with the provisions of Article 27.4 of that Agreement;
- (c) whether the Panel erred in interpreting and applying the phrase "shall not increase the level of its export subsidies" under Article 27.4 of the *SCM Agreement*, in particular, in finding that:
 - i) the "proper point of reference" for the purpose of determining whether a Member has increased the level of its export subsidies is actual expenditures, rather than budgeted amounts;
 - ii) the export subsidies for regional aircraft under PROEX should be considered to be "granted" when the NTN-I bonds are issued, rather than when the letter of commitment is issued; and
 - iii) it is appropriate in this case to use constant dollars, rather than nominal dollars, in assessing whether Brazil has increased the level of its export subsidies;
- (d) whether the Panel erred in finding that Brazil had failed to demonstrate that the export subsidies for regional aircraft under PROEX are not "used to secure a material advantage in the field of export credit terms" under item (k) of the Illustrative List;
- (e) whether the Panel erred in recommending that Brazil withdraw its subsidies within 90 days; and
- (f) if we find that the export subsidies for regional aircraft under PROEX are "granted" at the time of issuance of a letter of commitment, whether the subsequent issuance of NTN-I bonds is consistent with Brazil's obligation not to "maintain" prohibited export subsidies under Article 3.2 of the *SCM Agreement*.

V. Consultations

127. Brazil argues on appeal that certain regulatory instruments relating to PROEX were not properly before the Panel because those instruments came into effect in 1997 and 1998 – after consultations were held between Canada and Brazil.³⁹ Canada maintains that these instruments were properly before the Panel because Canada's request for consultations⁴⁰, dated 18 June 1996, and its request for the establishment of a panel⁴¹, dated 10 July 1998, referred to the same "matter", that is, to "PROEX and prohibited subsidies granted thereunder."⁴² Furthermore, according to Canada, "the programme has remained unchanged *in its essence*."⁴³

128. On this preliminary objection by Brazil, the Panel made the following ruling:

Applying this analysis to the case at hand, we recall that Brazil and Canada consulted "regarding certain export subsidies granted under the Brazilian *Programa de Financiamento às Exportações* (PROEX) to foreign purchasers of Brazil's EMBRAER aircraft", and that the request for establishment of a panel relates to "export subsidies under PROEX". We consider that the consultations and request for establishment relate to what is fundamentally the same "dispute", because they involve essentially the same practice, i.e., the payment of export subsidies under PROEX. Under these circumstances, and notwithstanding the fact that both the authorizing legal instrument and certain other legal instruments relating to the administration of the PROEX interest equalization regime changed or were only introduced subsequent to the last consultations, we cannot say that Canada has failed to comply with the requirements of Article 4.7 of the DSU.⁴⁴

129. In its request for consultations of 18 June 1996, Canada described the specific measures at issue as "certain export subsidies granted under the Brazilian *Programa de Financiamento às Exportações* (PROEX) to foreign purchasers of Brazil's Embraer aircraft".⁴⁵ In its request for the establishment of a panel, Canada identified the specific measures at issue as follows:

On 18 June 1996, the Government of Canada requested consultations with the Government of Brazil concerning certain export subsidies granted under the *Programa de Financiamento às Exportações* (PROEX) to foreign purchasers of Brazil's Embraer aircraft.

³⁹Brazil's appellant's submission, paras. 4-18.

⁴⁰WT/DS46/1, G/SCM/D3/1, 21 June 1996.

⁴¹WT/DS46/5, 13 July 1998.

⁴²Canada's appellee's submission, para. 30.

⁴³*Ibid.*

⁴⁴Panel Report, para. 7.11.

⁴⁵WT/DS46/1, G/SCM/D3/1, 21 June 1996.

...

The Brazilian measures in question *include* Provisional Measure 1700-15 replacing Provisional Measure 1629-13 and Law 8187 establishing PROEX; Law no. 8249/91; Decree no. 2414 of December 8, 1997; Resolutions of the National Monetary Council nos. 2490/98, 2452/97; 2381/97, 2380/97, 2224/95; Circular DIRIN 5; Resolution No. 50 of the Federal Senate of June 13, 1993; MICT Orders 28/98, 23/98, 7/98, 121/97, 83/97, 53/97, 34/97, 33/97 and MF/MICT Order 314/95; and Central Bank Circular no. 2601. *These measures provide for the payment of export subsidies through interest rate equalization and export financing programmes under PROEX.*⁴⁶ (emphasis added)

130. We note that Brazil and Canada consulted about "certain export subsidies granted under the Brazilian *Programa de Financiamento às Exportações* (PROEX) to foreign purchasers of Brazil's Embraer aircraft"⁴⁷, and that the request for the establishment of a panel also relates to "the payment of export subsidies through interest rate equalization and export financing programmes under PROEX."⁴⁸ We have been advised by Brazil that the regulatory instruments that came into effect in 1997 and 1998, after the consultations had taken place, and that relate to the administration of PROEX, did not change the essence of that regime.⁴⁹

131. In our view, Articles 4 and 6 of the DSU, as well as paragraphs 1 to 4 of Article 4 of the *SCM Agreement*, set forth a process by which a complaining party must request consultations, and consultations must be held, before a matter may be referred to the DSB for the establishment of a panel. Under Article 4.3 of the *SCM Agreement*, moreover, the purpose of consultations is "to clarify the facts of the situation and to arrive at a mutually agreed solution."

132. We do not believe, however, that Articles 4 and 6 of the DSU, or paragraphs 1 to 4 of Article 4 of the *SCM Agreement*, require a *precise and exact identity* between the specific measures that were the subject of consultations and the specific measures identified in the request for the establishment of a panel. As stated by the Panel, "[o]ne purpose of consultations, as set forth in Article 4.3 of the *SCM Agreement*, is to 'clarify the facts of the situation', and it can be expected that information obtained during the course of consultations may enable the complainant to focus the

⁴⁶WT/DS46/5, 13 July 1998.

⁴⁷WT/DS46/1, G/SCM/D3/1, 21 June 1996.

⁴⁸WT/DS46/5, 13 July 1998.

⁴⁹Answer by Brazil to questions at the oral hearing, 17 June 1999. These specific measures are listed in paragraph 11, *supra*.

scope of the matter with respect to which it seeks establishment of a panel."⁵⁰ We are confident that the specific measures at issue in this case are the Brazilian export subsidies for regional aircraft under PROEX. Consultations were held by the parties on these subsidies, and it is these same subsidies that were referred to the DSB for the establishment of a panel. We emphasize that the regulatory instruments that came into effect in 1997 and 1998 did not change the essence of the export subsidies for regional aircraft under PROEX.

133. For these reasons, we conclude that the export subsidies for regional aircraft under PROEX, including the regulatory instruments that came into effect after consultations were held between Canada and Brazil, were properly before the Panel.

VI. Burden of Proof Under Article 27.4 of the *SCM Agreement*

134. Canada appeals the Panel's finding that, in a case involving a claim of violation of Article 3.1(a) against a developing country Member, the complaining party has the burden of demonstrating that the developing country Member in question has not complied with at least one of the elements of Article 27.4.

135. The Panel found as follows:

Where, as here, it is agreed that the Member in question is a developing country Member within the meaning of Article 27.2(b), it is for the Member alleging a violation of Article 3.1(a) of the SCM Agreement to demonstrate that the substantive obligation in that provision -- the prohibition on export subsidies -- applies to the developing country Member complained against. That is, it is for the complaining Member to demonstrate that the developing country Member in question is not in compliance with at least one of the elements laid out in Article 27.4.⁵¹

136. Canada asserts that Article 27.4 is in the nature of a conditional exception or an affirmative defence for a developing country Member, and that, therefore, the burden of proof rests with the respondent developing country Member – in this case, Brazil.⁵² Brazil, on the other hand, maintains that Article 27 is a transitional provision that contains a set of special and differential rights and obligations for developing country Members, and that, therefore, the complaining party – here,

⁵⁰Panel Report, para. 7.9.

⁵¹*Ibid.*, para. 7.57.

⁵²Canada's appellant's submission, paras. 15-21.

Canada – has the burden of proving that the developing country Member is not in compliance with Article 27.4.⁵³

137. In *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, we stated that "the burden of proof rests upon the party ... who asserts the *affirmative of a particular claim or defence*."⁵⁴ (emphasis added) There, we also noted that "Articles XX and XI:(2)(c)(i) are limited exceptions from obligations under certain other provisions of the GATT 1994, not positive rules establishing obligations in themselves. They are in the nature of affirmative defences."⁵⁵ We have also stated previously that the simple characterization of a provision of an agreement as an "exception" to a specific obligation does not, in itself, determine which party has the burden of proof. In *EC Measures Concerning Meat and Meat Products (Hormones)*, we stated:

The general rule in a dispute settlement proceeding requiring a complaining party to establish a *prima facie* case of inconsistency with a provision of the *SPS Agreement* before the burden of showing consistency with that provision is taken on by the defending party, is *not* avoided by simply describing that same provision as an "exception".⁵⁶

138. Article 3.1(a) of the *SCM Agreement*, states, in relevant part:

3.1 ... the following subsidies, within the meaning of Article 1, shall be prohibited:

- (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;

...

Article 27.2(b) of the *SCM Agreement* provides as follows:

27.2 The prohibition of paragraph 1(a) of Article 3 *shall not apply* to:

...

- (b) other developing country Members for a period of eight years from the date of entry into force of the WTO Agreement, *subject to compliance with the provisions in paragraph 4*.

(emphasis added)

⁵³Brazil's appellee's submission, paras. 2-12.

⁵⁴Adopted 23 May 1997, WT/DS33/AB/R, p. 14.

⁵⁵*Ibid.*, p. 16.

⁵⁶Adopted 13 February 1998, WT/DS26/AB/R, WT/DS48/AB/R, para. 104.

Article 27.4 of the *SCM Agreement* reads, in relevant part:

27.4 Any developing country Member referred to in paragraph 2(b) shall phase out its export subsidies within the eight-year period, preferably in a progressive manner. However, a developing country Member shall not increase the level of its export subsidies⁵⁵, and shall eliminate them within a period shorter than that provided for in this paragraph when the use of such export subsidies is inconsistent with its development needs.

⁵⁵For a developing country Member not granting export subsidies as of the date of entry into force of the WTO Agreement, this paragraph shall apply on the basis of the level of export subsidies granted in 1986.

139. The ordinary meaning of the text of Article 27.2(b) is clear. For a period of eight years after the date of entry into force of the *WTO Agreement*, the prohibition on export subsidies in paragraph 1(a) of Article 3 of the *SCM Agreement* *does not apply* to developing country Members described in Article 27.2(b) – as long as they comply with the provisions of Article 27.4. With respect to the *application* of the prohibition of export subsidies in Article 3.1(a) of the *SCM Agreement*, paragraphs 2 and 4 of Article 27 contain a carefully negotiated balance of rights and obligations for developing country Members. During the transitional period from 1 January 1995 to 1 January 2003, certain developing country Members are *entitled* to the *non-application* of Article 3.1(a), *provided* that they comply with the specific obligations set forth in Article 27.4. Put another way, when a developing country Member complies with the conditions in Article 27.4, a claim of violation of Article 3.1(a) cannot be entertained during the transitional period, because the export subsidy prohibition in Article 3 simply *does not apply* to that developing country Member.

140. The title of Article 27 is "Special and Differential Treatment of Developing Country Members". Paragraph 1 of that Article provides that "Members recognize that subsidies may play an important role in economic development programmes of developing country Members." Both from its title and from its terms, it is clear that Article 27 is intended to provide special and differential treatment for developing country Members, under certain specified conditions. In our view, too, paragraph 4 of Article 27 provides certain obligations that developing country Members must fulfill if they are to benefit from this special and differential treatment during the transitional period. On reading paragraphs 2(b) and 4 of Article 27 together, it is clear that the conditions set forth in paragraph 4 are *positive obligations* for developing country Members, *not* affirmative defences. If a developing country Member complies with the obligations in Article 27.4, the prohibition on export subsidies in Article 3.1(a) simply does not apply. However, if that developing country Member does *not* comply with those obligations, Article 3.1(a) *does* apply.

141. For these reasons, we agree with the Panel that the burden is on the complaining party (*in casu* Canada) to demonstrate that the developing country Member (*in casu* Brazil) is not in compliance with at least one of the elements set forth in Article 27.4. If such non-compliance is demonstrated, then, and only then, does the prohibition of Article 3.1(a) *apply* to that developing country Member.

VII. Has Brazil Increased the Level of its Export Subsidies?

142. Our ruling on the issue of the burden of proof under Article 27.4 has implications not only for determining which party has the burden of proof in demonstrating whether the conditions of Article 27.4 are met, but also for determining whether or not Article 3.1(a) *applies* to the developing country Member in question. In this case, the Panel, having determined correctly that the complaining party had the burden of proof in demonstrating whether the developing country Member had complied with Article 27.4, then failed to apply the logic of its own reasoning in examining Canada's claim that Brazil had acted inconsistently with its obligations under Article 3.1(a).

143. The Panel commenced its legal reasoning by considering whether the interest rate equalization payments for regional aircraft under PROEX constitute "subsidies" within the meaning of Article 1 of the *SCM Agreement* which are "contingent ... upon export performance" within the meaning of Article 3.1(a) of that Agreement.⁵⁷ As Brazil had not disputed these two issues, the Panel concluded that the payments under PROEX relating to exports of Brazilian regional aircraft are subsidies contingent upon export performance.⁵⁸ The Panel then went on to examine an "affirmative defence" put forward by Brazil, that is, whether PROEX support for the regional aircraft industry, even if it did constitute an "export subsidy", was nevertheless "permitted" by item (k) of the Illustrative List.⁵⁹ Given the Panel's correct analysis of the relationship between Articles 27 and 3.1(a) in its reasoning on the burden of proof⁶⁰, we find it odd that the Panel then went on to examine, in the following order: first, whether the conditions of Article 3.1(a) of the *SCM Agreement* had been met; next, a contention by Brazil of an "affirmative defence" to a claim of violation of Article 3.1(a), based on item (k) of the Illustrative List; and, only then, whether Brazil had complied with the conditions of Article 27.4 so as to determine whether the prohibition of export subsidies in Article 3.1(a) even *applied* to Brazil in this case. The Panel should not have considered Brazil's

⁵⁷Panel Report, paras. 7.12-7.13.

⁵⁸*Ibid.*, para. 7.14.

⁵⁹*Ibid.*, paras. 7.15-7.37.

⁶⁰*Ibid.*, paras. 7.49 and 7.56-7.57.

"affirmative defence" based on item (k) of the Illustrative List *before* determining whether Article 3.1(a) even applied to Brazil.

144. Our interpretation of the relationship between Article 27 and Article 3.1(a) of the *SCM Agreement* leads us, in this appeal, to examine, first, the issues appealed relating to whether Brazil has increased the level of its export subsidies contrary to the provisions of Article 27.4. Only if we determine that Brazil has not complied with the conditions of Article 27.4, and thereby find that the provisions of Article 3.1(a) do in fact *apply* to Brazil, will we need to examine Brazil's appeal of the Panel's findings relating to its alleged "affirmative defence" under item (k) of the Illustrative List.

145. The Panel made a number of findings in its analysis of whether Brazil has increased "the level of its export subsidies" under Article 27.4 of the *SCM Agreement*. Brazil appeals two of these findings, and Canada appeals one. Brazil appeals the Panel's finding that actual expenditures, rather than budgeted amounts, is the "proper point of reference" for determining whether Brazil has increased the level of its export subsidies.⁶¹ Brazil also appeals the Panel's finding that PROEX subsidies for regional aircraft are "granted" when the NTN-I bonds are issued, not when the letter of commitment is issued. Canada appeals the Panel's conclusion that it is appropriate, in this case, to use constant dollars, rather than nominal dollars, in assessing whether Brazil has increased the level of its export subsidies.

A. *Actual Expenditures or Budgeted Amounts*

146. Brazil argues that the Panel erred in using actual expenditures, rather than budgetary appropriations, in determining whether Brazil had increased the level of its export subsidies.⁶² Canada argues that the Panel was correct in examining actual expenditures, rather than budgetary appropriations.⁶³

147. The Panel found that "the level of a Member's export subsidies in its ordinary meaning refers to the level of subsidies *actually provided*, not the level of subsidies which a Member planned or authorized its government to provide through its budgetary process."⁶⁴ (emphasis added) The Panel said this view was confirmed by footnote 55 to the *SCM Agreement*, which provides that, "[f]or a developing country Member not *granting* export subsidies as of the date of entry into force of the *WTO Agreement*, this paragraph shall apply on the basis of the level of export subsidies *granted*

⁶¹Panel Report, para. 7.65.

⁶²Brazil's appellant's submission, paras. 19-25.

⁶³Canada's appellee's submission, paras. 48-62.

⁶⁴Panel Report, para. 7.65.

in 1986." (emphasis added) The Panel noted that "[t]he verb 'grant' has been defined to mean, *inter alia*, 'to bestow by a formal act' and 'give, bestow, confer'." ⁶⁵

148. We agree with the Panel's reasoning on this issue. To us, the word "granted" used in this context means "something actually provided". Thus, to determine the amount of export subsidies "granted" in a particular year, we believe that the actual amounts *provided* by a government, and not just those *authorized* or *appropriated* in its budget for that year, is the proper measure. A government does not always spend the entire amount appropriated in its annual budget for a designated purpose. Therefore, in this case, to determine the level of export subsidies for the purposes of Article 27.4, we believe that the proper reference is to actual expenditures by a government, and not to budgetary appropriations.

149. In coming to this conclusion, we are not persuaded by Brazil's argument relating to the notification provisions of Article 25 of the *SCM Agreement*. We note that Article 25 has a fundamentally different purpose from Article 27 of the *SCM Agreement*. Whereas Article 25 aims to promote transparency by requiring Members to notify their subsidies, without prejudging the legal status of those subsidies⁶⁶, Article 27 imposes positive obligations on developing country Members with respect to export subsidies. In interpreting the phrase "the level of its export subsidies" in Article 27.4, we believe the most appropriate context is footnote 55, which is, it will be recalled, a footnote to that very phrase in Article 27.4. Because of its different purpose, Article 25 is considerably less useful as context in interpreting the phrase "the level of its export subsidies" in Article 27.4. Moreover, the provisions of Article 25 do not contradict the conclusion we draw from footnote 55. In particular, in paragraph 3 of Article 25, Members are required to ensure that their notifications contain, *inter alia*, the following information:

...

- (ii) *subsidy per unit* or, *in cases where this is not possible*, the *total amount* or the *annual amount budgeted* for that subsidy ...
(emphasis added)

We note that the *preferred* notification method is on the basis of subsidy per unit. It is only in cases where it is not possible to provide information on that basis that the total amount, or the annual amount budgeted for that subsidy, may be reported. For transparency purposes, we can understand why Members would want to know what subsidies other Members have planned or projected. Yet

⁶⁵Panel Report, para. 7.65.

⁶⁶Article 25.7 of the *SCM Agreement* states that "notification of a measure does not prejudice either its legal status under GATT 1994 and this Agreement, the effects under this Agreement, or the nature of the measure itself."

this consideration is different from the objective of determining whether a developing country Member has increased "the level of its export subsidies" under Article 27.4.

150. Accordingly, we uphold the finding of the Panel that the "proper point of reference" in determining whether a Member has increased the level of its export subsidies under Article 27.4 is actual expenditures, rather than budgeted amounts or appropriations.⁶⁷

B. *When are PROEX Subsidies "Granted"?*

151. One of the legal issues the Panel considered in determining whether Brazil had increased the level of its export subsidies was "the question of when PROEX payments should be considered to have been 'granted' for the purposes of calculating the level of Brazil's export subsidies in terms of expenditures."⁶⁸ In examining this issue, the Panel considered two questions: *what is the form of "financial contribution" made by PROEX, within the meaning of Article 1.1(a)(1) of the SCM Agreement? And, when does the "subsidy" that is created, in part, by that "financial contribution", "exist" within the meaning of Article 1.1? Brazil argued, before the Panel, that the form of financial contribution involved in this dispute is a "potential direct transfer of funds", within the meaning of Article 1.1(a)(1)(i), which "exists" at the time a letter of commitment is issued.⁶⁹ Canada argued, before the Panel, that PROEX subsidies for regional aircraft involve a "direct transfer of funds", within the meaning of Article 1.1(a)(1)(i), which "exists" either when payments are made pursuant to an NTN-I bond or, in the alternative, when NTN-I bonds are issued to an agent bank.⁷⁰*

152. In analyzing the form of "financial contribution" made by export subsidies for regional aircraft under PROEX, the Panel said, *inter alia*:

We believe that a "potential direct transfer of funds" exists only where the action in question gives rise to a benefit and thus confers a subsidy irrespective of whether any payment occurs.⁷¹

...

⁶⁷Panel Report, para. 7.65.

⁶⁸*Ibid.*, para. 7.67.

⁶⁹*Ibid.*, paras. 4.20 and 7.67.

⁷⁰*Ibid.*, paras. 4.22 and 7.67.

⁷¹*Ibid.*, para. 7.68.

... In this case, however, it clearly is not the alleged "potential direct transfer of funds", i.e., the letter of commitment, that confers the benefit. Rather, the benefit in the PROEX interest rate equalization scheme derives from the fact that a payment, i.e., a direct transfer of funds, has been or will be made.⁷²

153. The Panel then posed the question of *when* Brazil can be considered to "grant" PROEX payments. The Panel gave the following answer:

As noted above, the verb "grant" has been defined to mean, *inter alia*, "to bestow by formal act" and "give, bestow, confer". Arguably, therefore PROEX payments may be "granted" where the unconditional legal right of the beneficiary to receive the payments has arisen, even if the payments themselves have not yet occurred. It is clear to us, however, that PROEX payments have not yet been "granted" at the time a letter of commitment is issued. We note that the issuance of a letter of commitment, even if legally binding on the Government of Brazil in the event certain conditions are fulfilled, provides no assurance that PROEX payments will actually be made. To the contrary, at the time the letter of commitment is issued no export sales contract has been signed, and the letter of commitment expires if a contract that conforms to the request for approval is not negotiated and signed within 90 days. ... Rather, the right to receive the PROEX payments only arises after the conditions relating to receipt of PROEX payments, and specifically the condition that the product in question actually be exported, has been fulfilled.⁷³

154. In our view, the Panel reached the correct conclusion. However, it did so on the basis of faulty reasoning. The issue in this case is when the subsidies for regional aircraft under PROEX should be considered to have been "granted" *for the purposes of calculating the level of Brazil's export subsidies under Article 27.4 of the SCM Agreement*. The issue is *not* whether or when there is a "financial contribution", or whether or when the "subsidy" "exists", within the meaning of Article 1.1 of that Agreement.

155. The Panel noted, early in its findings, that Brazil did not dispute the assertion by Canada that PROEX support for the regional aircraft industry constitutes an export subsidy.⁷⁴ On this, the Panel stated:

⁷²Panel Report, para. 7.70.

⁷³*Ibid.*, para. 7.71.

⁷⁴*Ibid.*, para. 7.12.

As noted above, the parties agree that PROEX payments are subsidies within the meaning of Article 1 of the SCM Agreement which are contingent upon exportation within the meaning of Article 3.1(a) of the Agreement, and we agree with them.⁷⁵

156. Thus, the issue before the Panel under the heading "Has Brazil increased the level of its export subsidies?"⁷⁶ was simply this: given that the export subsidies in this case were already deemed to "exist", when were they "granted"? At issue was the interpretation and application of Article 27.4, *not* of Article 1. It is pursuant to the provisions of Article 27.4 that Brazil is obliged not to increase "the level of its export subsidies". And, to ascertain the meaning of this phrase, it is necessary to look, again, at footnote 55, which is affixed to Article 27.4 and which speaks of "the level of export subsidies *granted*" (emphasis added) by a developing country Member. Consequently, for the purposes of Article 27.4, we see the issue of the *existence* of a subsidy and the issue of the point at which that subsidy is *granted* as two legally distinct issues. Only one of those issues is raised here and, therefore, must be addressed. That issue is: when is this subsidy, which admittedly exists, actually *granted*?

157. In our view, the Panel did not have to determine whether the export subsidies for regional aircraft under PROEX constituted a "direct transfer of funds" or a "potential direct transfer of funds", within the meaning of Article 1.1(a)(i), in order to determine when the subsidies are "granted" for the purposes of Article 27.4. Moreover, the Panel compounded its error in finding that the "financial contribution" in the case of PROEX subsidies is *not* a "potential direct transfer of funds" by reasoning that a letter of commitment does not confer a "benefit".⁷⁷ In this way, in its interpretation of Article 1.1(a)(i), the Panel imported the notion of a "benefit" into the definition of a "financial contribution". This was a mistake. We see the issues – and the respective definitions – of a "financial contribution" and a "benefit" as two separate legal elements in Article 1.1 of the *SCM Agreement*, which *together* determine whether a subsidy *exists*, and not whether it is *granted* for the purpose of calculating the level of a developing country Member's export subsidies under Article 27.4 of that Agreement.

158. In addressing the correct legal question under Article 27.4, our answer is that export subsidies for regional aircraft under PROEX are "granted" when the NTN-I bonds are issued. We agree with the Panel that "PROEX payments may be 'granted' where the unconditional legal right of the beneficiary to receive the payments has arisen, even if the payments themselves have not yet

⁷⁵Panel Report, para. 7.13.

⁷⁶*Ibid.*, top of p. 95.

⁷⁷*Ibid.*, para. 7.70.

occurred."⁷⁸ We also agree with the Panel that the export subsidies for regional aircraft under PROEX have not yet been "granted" when the letter of commitment is issued, because, at that point, the export sales contract has not yet been concluded and the export shipments have not yet occurred.⁷⁹ For the purposes of Article 27.4, we conclude that the export subsidies for regional aircraft under PROEX are "granted" when all the legal conditions have been fulfilled that entitle the beneficiary to receive the subsidies. We share the Panel's view that such an unconditional legal right exists when the NTN-I bonds are issued.⁸⁰

159. For these reasons, we uphold the Panel's conclusion that the export subsidies for regional aircraft under PROEX are "granted", for the purposes of Article 27.4 of the *SCM Agreement*, when the NTN-I bonds are issued, and not when the letter of commitment is issued. However, we wish to emphasize the modifications we have made in the Panel's legal reasoning. We wish to underscore especially that we find that it was not relevant, for the purpose of calculating the level of Brazil's export subsidies under Article 27.4, for the Panel to decide whether the "financial contribution" for PROEX subsidies involved a "direct transfer of funds" or a "potential direct transfer of funds" under Article 1.1 of the *SCM Agreement*.

C. *Constant or Nominal Dollars*

160. On appeal, Canada argues that the Panel's statement that it was "appropriate in this case" to use constant dollars, rather than nominal dollars, to assess whether Brazil had increased the level of its export subsidies is "unreasoned" and "does not respect the text, context and the object and purpose of the *SCM Agreement*."⁸¹ Canada maintains that there is no explicit provision for the conversion of the level of export subsidies to a constant value either in Article 27.4 or in footnote 55 of the *SCM Agreement*. With respect to the context of the *SCM Agreement*, Canada asserts that, where the negotiators intended to provide adjustments for inflation, they did so, but that such indexation is not so provided in Article 27.⁸² In reply, Brazil argues that the Panel was correct in its conclusion based on the facts of this case. Brazil contends that the use of a constant value is required if the special rules for developing country Members in Article 27 are to be given genuine meaning.⁸³

⁷⁸Panel Report, para. 7.71.

⁷⁹*Ibid.*

⁸⁰*Ibid.*, para. 7.72.

⁸¹Canada's appellant's submission, para. 24.

⁸²*Ibid.*, paras. 28-30.

⁸³Brazil's appellee's submission, paras. 17-18.

161. On this issue, the Panel said the following:

In our view, however, *it is appropriate in this case* to use constant dollars, as that will provide a more meaningful assessment as to whether Brazil has increased the level of its export subsidies. We note that, in this case, *the conclusion with respect to this issue would be the same whether constant or nominal dollars are used.*⁸⁴ (emphasis added)

...

The Panel concluded:

Applying the foregoing criteria to these *undisputed data*, we conclude that Brazil had by 1997 increased the level of its export subsidies above that prevailing in 1994, *whether the data are expressed in nominal or in constant dollars*. The increase for 1998 was even more substantial than that for 1997, reflecting as it does data for only the first ten months of the year.⁸⁵ (emphasis added)

162. We note that the Panel did *not* make a legal finding that the level of a developing country Member's export subsidies must be measured, in every case, using a constant value. The Panel simply made a pragmatic observation that using constant dollars is appropriate *in this case*. The Panel also noted that, in this case, "the conclusion with respect to this issue *would be the same* whether constant or nominal dollars are used."⁸⁶ (emphasis added) In examining the data before it relating to Brazilian export subsidies under PROEX and BEFIEEX, the Panel examined data denominated *both* in current US dollars and in 1994 constant US dollars.⁸⁷ The conclusion of the Panel was "that Brazil had by 1997 increased the level of its export subsidies above that prevailing in 1994, *whether the data are expressed in nominal or in constant dollars.*"⁸⁸ (emphasis added)

163. As the Panel relied on data denominated *both* in current dollars and in constant dollars, we see no reason to overturn this conclusion of the Panel. Moreover, in our view, to take no account of inflation in assessing the level of export subsidies granted by a developing country Member would render the special and differential treatment provisions of Article 27 meaningless. For these reasons, we uphold the conclusion of the Panel in paragraph 7.75 of the Panel Report.

⁸⁴Panel Report, para. 7.73.

⁸⁵*Ibid.*, para. 7.75.

⁸⁶*Ibid.*, para. 7.73.

⁸⁷*Ibid.*, para. 7.75, Table 9.

⁸⁸*Ibid.*, para. 7.75.

164. And, for all these reasons, we uphold the overall conclusion of the Panel, in paragraph 7.76 of the Panel Report, that "Brazil has 'increased the level of its export subsidies' within the meaning of Article 27.4 of the SCM Agreement." And, thus, we find that Article 3.1(a) applies to Brazil in this case, because Brazil has not complied with the provisions of Article 27.4.

VIII. Are PROEX Interest Rate Equalization Payments Used "To Secure a Material Advantage in the Field of Export Credit Terms"?

165. Having determined that Brazil has not complied with the provisions of Article 27.4, we conclude that the prohibition of Article 3.1(a) applies to Brazil in this case. We must therefore examine Brazil's appeal of the finding of the Panel relating to Brazil's alleged "affirmative defence" under item (k) of the Illustrative List.

166. Brazil appeals the Panel's conclusion that Brazil failed to demonstrate that PROEX payments are not "used to secure a material advantage in the field of export credit terms", and the Panel's consequent rejection of Brazil's "affirmative defence" based on item (k) of the Illustrative List.⁸⁹ Brazil argues that the Panel erred in its interpretation of the phrase "used to secure a material advantage in the field of export credit terms", both with respect to the ordinary meaning of the word "secure"⁹⁰ and by determining "advantage" with respect to "the terms that would have been available in the absence of the payment".⁹¹ Also, Brazil contends that the Panel misconstrued the context of the "material advantage" clause, in particular, in its assessment of the origins of item (k) in the *Tokyo Round SCM Code*.⁹²

167. In Canada's view, the Panel did not err in its interpretation of the "material advantage" clause in item (k), either with respect to its analysis of the ordinary meaning or the context of that clause.⁹³ Thus, Canada argues that the Panel properly rejected Brazil's alleged "affirmative defence" based on item (k).

⁸⁹Brazil's appellant's submission, paras. 47-52. From Brazil's responses to questioning during the oral hearing, we understand Brazil's underlying argument to be the following: PROEX subsidies are not "used to secure a material advantage" in the sense of item (k) because they are designed only to offset "Brazil risk" and to "match" the subsidies given by the Government of Canada to Bombardier – the competitor of Embraer in the regional aircraft industry.

⁹⁰Brazil's appellant's submission, paras. 53-57.

⁹¹*Ibid.*, paras. 58-60.

⁹²*Ibid.*, paras. 61-66.

⁹³Canada's appellee's submission, paras. 144-158.

168. Item (k) of the Illustrative List provides as follows:

- (k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, *in so far as they are used to secure a material advantage in the field of export credit terms.*

Provided, however, that if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.

(emphasis added)

169. Before the Panel, Brazil contended that, although PROEX payments are export subsidies, they are nevertheless "permitted" by item (k) of the Illustrative List.⁹⁴ The Panel noted that to rule in favour of Brazil on this issue, it would need to find for Brazil on all of the following three points: first, that PROEX payments are "the payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits"; second, that PROEX payments are not "used to secure a material advantage in the field of export credit terms"; and, third, that a "payment" within the meaning of item (k) which is not "used to secure a material advantage in the field of export credit terms" is "permitted" by the *SCM Agreement* even though it is a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) of that Agreement. The Panel also noted that Brazil had explicitly acknowledged that the "material advantage" clause in item (k) constitutes an "affirmative defence", and, therefore, that the burden of establishing that "defence" was on Brazil.⁹⁵

⁹⁴Panel Report, para. 7.15.

⁹⁵*Ibid.*, para. 7.17.

170. The Panel concluded as follows:

In conclusion, we consider that an item (k) payment is "used to secure a material advantage" where the payment has resulted in the availability of export credit on terms which are more favourable than the terms that would otherwise have been be [sic] available to the purchaser with respect to the transaction in question. Even if we were to assume, as argued by Brazil, that PROEX payments are the "payment by [a government] of all or part of the costs incurred by exporters or financial institutions in obtaining credits", and that such payments can be deemed to be "permitted" by item (k) where they are not "used to secure a material advantage in the field of export credit terms" -- issues we need not here decide -- Brazil has failed to demonstrate the PROEX payments are not "used to secure a material advantage in the field of export credit terms". Accordingly, we reject Brazil's affirmative defense based on item (k) of the Illustrative List.⁹⁶

171. In coming to this conclusion, the Panel first interpreted the phrase "used to secure a material advantage in the field of export credit terms", and then applied its interpretation to the facts relating to export subsidies for regional aircraft under PROEX. In its reasoning on this issue, the Panel made four, not entirely consistent, statements of its interpretation.⁹⁷

172. In examining the ordinary meaning of the phrase "used to secure a material advantage in the field of export credit terms" in item (k), the Panel noted that the word "advantage" has been defined as "a more favorable or improved position" and as a "superior position".⁹⁸ The Panel also concurred with Brazil that "advantage" involves the concept of comparison. The Panel went on to say, however, that:

... nothing in the text of the first paragraph of item (k) indicates that the examination of material advantage involves a comparison *with the export credit terms available with respect to competing products from other Members*. To the contrary, we consider that, in its ordinary meaning, a payment is "used to secure a material advantage in the field of export credit terms" where the payment is used to secure export credit terms that are materially more favorable than the terms that would have been available in the absence of the payment. Accordingly, we consider that an item (k) payment is "used to secure a material advantage" where the payment has resulted in the availability of export credit on terms which are more favourable than the terms that would otherwise be available in the marketplace to the purchaser with respect to the transaction in question.⁹⁹

(italics in the original, underlining added)

⁹⁶Panel Report, para. 7.37.

⁹⁷*Ibid.*, paras. 7.23, 7.33 and 7.37.

⁹⁸*Ibid.*, para. 7.23.

⁹⁹*Ibid.*

173. The Panel then considered the context of the "material advantage" clause generally in the *SCM Agreement*, and stated that, "the general approach of the *SCM Agreement* to determining whether a measure is a subsidy and thus subject to discipline is whether the measure confers a 'benefit' within the meaning of Article 1."¹⁰⁰ The Panel also discussed its view of the object and purpose of the *SCM Agreement*, which it stated "is to impose multilateral disciplines on subsidies which distort international trade."¹⁰¹ The Panel reasoned that Brazil's approach of allowing a Member to "match" the export subsidies granted by another Member "would entail a race to the bottom, as each WTO Member sought to justify the provision of export subsidies on the grounds that other Members were doing the same."¹⁰²

174. Then, before examining the facts, the Panel again stated its interpretation of the "material advantage" clause in item (k), this time, as follows:

For the reasons discussed above, we consider that an item (k) payment is "used to secure a material advantage" and is thus a prohibited export subsidy where the payment has resulted in the availability of export credit on terms which are *more favourable than the terms that would otherwise be available in the marketplace to the purchaser with respect to the transaction in question.*¹⁰³ (emphasis added)

175. Finally, in its concluding paragraph, the Panel repeated its interpretation of the "material advantage" clause of item (k) as follows:

In conclusion, we consider that an item (k) payment is "used to secure a material advantage" where the payment has resulted in the availability of export credit on terms which are *more favourable than the terms that would otherwise have been be [sic] available to the purchaser with respect to the transaction in question.*¹⁰⁴ (emphasis added)

176. We note that, in its very first statement of its interpretation of the "material advantage" clause, the Panel characterized "material advantage" as "*materially* more favorable than the terms that would have been available in the absence of the payment."¹⁰⁵ (emphasis added) However, we observe also that, in its subsequent statements, the Panel interpreted "material advantage" as simply "more favourable than the terms that would otherwise be available in the marketplace to the purchaser with

¹⁰⁰Panel Report, para. 7.24.

¹⁰¹*Ibid.*, para. 7.26.

¹⁰²*Ibid.*

¹⁰³*Ibid.*, para. 7.33.

¹⁰⁴*Ibid.*, para. 7.37.

¹⁰⁵*Ibid.*, para. 7.23 (second to last sentence).

respect to the transaction in question."¹⁰⁶ (emphasis added) In the latter interpretation, the Panel omitted the word "material".

177. As always, we examine the terms of the provision at issue, in this case, the "material advantage" clause of item (k). We look first to the ordinary meaning of the language used. We agree with the Panel's statement that the ordinary meaning of the word "advantage" is "a more favorable or improved position" or a "superior position". However, we note that item (k) does not refer simply to "advantage". The word "advantage" is qualified by the adjective "material". As mentioned before, in its ultimate interpretation of the phrase "used to secure a material advantage" which the Panel finally adopted and applied to the export subsidies for regional aircraft under PROEX, the Panel read the word "material" out of item (k). This, we consider to be an error.

178. We also note that in two of its interpretive statements¹⁰⁷, the Panel used the "marketplace" as the benchmark for comparing the subsidies on sales of regional aircraft under PROEX. However, in two other statements¹⁰⁸, the Panel made no reference to the "marketplace" as the basis for comparison. In one of those two statements, it referred, instead, more generally, to "the terms that would have been available in the absence of the payment." For the purposes of our analysis, we will assume that the Panel meant to use the "marketplace" as the benchmark for determining whether the PROEX subsidies were "used to secure a material advantage".

179. We note that the Panel adopted an interpretation of the "material advantage" clause in item (k) of the Illustrative List that is, in effect, the same as the interpretation of the term "benefit" in Article 1.1(b) of the *SCM Agreement* adopted by the panel in *Canada – Aircraft*.¹⁰⁹ If the "material advantage" clause in item (k) is to have *any* meaning, it must mean something different from "benefit" in Article 1.1(b). It will be recalled that for any payment to be a "subsidy" within the meaning of Article 1.1, that payment must consist of both a "financial contribution" and a "benefit". The first paragraph of item (k) describes a type of subsidy that is deemed to be a prohibited export subsidy. Obviously, when a payment by a government constitutes a "financial contribution" and confers a "benefit", it is, a "subsidy" under Article 1.1. Thus, the phrase in item (k), "in so far as they are used to secure a material advantage", would have no meaning if it were simply to be equated with

¹⁰⁶Panel Report, paras. 7.23 (last sentence), 7.33 and 7.37.

¹⁰⁷*Ibid.*, paras. 7.23 (last sentence) and 7.33.

¹⁰⁸*Ibid.*, paras. 7.23 (second to last sentence) and 7.37.

¹⁰⁹WT/DS70/R, circulated to WTO Members on 14 April 1999, paras. 9.112 and 9.120 (as upheld by the Appellate Body, *supra*, footnote 16, paras. 154-162).

the term "benefit" in the definition of "subsidy". As a matter of treaty interpretation, this cannot be so.¹¹⁰ Therefore, we consider it an error to interpret the "material advantage" clause in item (k) of the Illustrative List as meaning the same as the term "benefit" in Article 1.1(b) of the *SCM Agreement*.

180. We note that there are two paragraphs in item (k), and that the "material advantage" clause appears in the first paragraph. Furthermore, the second paragraph is a proviso to the first paragraph. The second paragraph applies when a Member is "a party to an international undertaking on official export credits" which satisfies the conditions of the proviso, or when a Member "applies the interest rates provisions of the relevant undertaking". In such circumstances, an "export credit practice" which is in conformity with the provisions of "an international undertaking on official export credits" shall not be considered an export subsidy prohibited by the *SCM Agreement*. The *OECD Arrangement* is an "international undertaking on official export credits" that satisfies the requirements of the proviso in the second paragraph in item (k). However, Brazil did not invoke the proviso in the second paragraph of item (k) in its defence. Brazil argued before the Panel that it "has concluded that conformity to the OECD provisions is too expensive."¹¹¹

181. Thus, this case falls under the first paragraph, and not under the proviso of the second paragraph, of item (k) of the Illustrative List. Consequently, the issue here is whether the export subsidies for regional aircraft under PROEX "are used to secure" for Brazil "a material advantage in the field of export credit terms". Nevertheless, we see the second paragraph of item (k) as useful context for interpreting the "material advantage" clause in the text of the first paragraph. The *OECD Arrangement* establishes minimum interest rate guidelines for export credits supported by its participants ("officially-supported export credits"). Article 15 of the Arrangement defines the minimum interest rates applicable to officially-supported export credits as the Commercial Interest Reference Rates ("CIRRs"). Article 16 provides a methodology by which a CIRR, for the currency of each participant, may be determined for this purpose. We believe that the *OECD Arrangement* can be appropriately viewed as one example of an international undertaking providing a specific market benchmark by which to assess whether payments by governments, coming within the provisions of item (k), are "used to secure a material advantage in the field of export credit terms". Therefore, in our view, the appropriate comparison to be made in determining whether a payment is "used to secure a material advantage", within the meaning of item (k), is between the actual interest rate applicable in

¹¹⁰As we stated in our report in *United States – Standards for Reformulated and Conventional Gasoline* ("*United States – Gasoline*"), "[a]n interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility." Adopted 20 May 1996, WT/DS2/AB/R, p. 23. This statement is quoted with approval in *Japan – Taxes on Alcoholic Beverages*, adopted 1 November 1996, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, p. 12.

¹¹¹Oral Statement of Brazil at First Meeting of the Panel, para. 22. See also Oral Statement of Brazil at Second Meeting of the Panel, paras. 54 and 56.

a particular export sales transaction after deduction of the government payment (the "*net* interest rate") and the relevant CIRR.

182. It should be noted that the commercial interest rate with respect to a loan in any given currency varies according to the length of maturity as well as the creditworthiness of the borrower. Thus, a potential borrower is not faced with a single commercial interest rate, but rather with a range of rates. Under the *OECD Arrangement*, a CIRR is the *minimum* commercial rate available in that range for a particular currency. In any given case, whether or not a government payment is used to secure a "*material* advantage", as opposed to an "advantage" that is not "*material*", may well depend on where the *net* interest rate applicable to the particular transaction at issue in that case stands in relation to the range of commercial rates available. The fact that a particular *net* interest rate is below the relevant CIRR is a positive indication that the government payment in that case has been "used to secure a material advantage in the field of export credit terms".

183. Brazil has conceded that it has the burden of proving an alleged "affirmative defence" under item (k). In light of our analysis, it was for Brazil to establish a *prima facie* case that the export subsidies for regional aircraft under PROEX do not result in net interest rates below the relevant CIRR. We note, however, that Brazil did not provide *any information* to the Panel on this point. We also note that Brazil declined to provide this information, even when specifically requested to do so by the Panel.¹¹² Because Brazil provided *no information* on the net interest rates paid by purchasers of Embraer aircraft in actual export sales transactions, we have no basis on which to compare the net interest rates resulting from the interest rate equalization payments made under PROEX with the relevant CIRR.

184. Accordingly, we find that Brazil has failed to meet its burden of proving that export subsidies for regional aircraft under PROEX are not "used to secure a material advantage in the field of export credit terms" within the meaning of item (k) of the Illustrative List.

185. We are aware that the *OECD Arrangement* allows a government to "match", under certain conditions, officially-supported export credit terms provided by another government. In a particular case, this could result in net interest rates below the relevant CIRR. We are persuaded that "matching" in the sense of the *OECD Arrangement* is not applicable in this case. Before the Panel, Brazil argued for an interpretation of the clause "in the field of export credit terms" that would include as an "export credit term" the price at which a product is sold, and maintained that, therefore, Brazil

¹¹²Reply of Brazil to the Panel's Questions for the Parties, 23 December 1998, Brazil's response to Question 34, pp. 7-8.

was entitled to "offset" *all the subsidies* provided to Bombardier by the Government of Canada. The Panel rejected Brazil's argument, finding instead that "[w]e see nothing in the ordinary meaning of the phrase to suggest that 'the field of export credit terms' generally encompasses the price at which a product is sold."¹¹³ We note that this finding was *not* appealed by either Brazil or Canada. Even if we were to assume that the "matching" provisions of the *OECD Arrangement* apply in this case (an argument Brazil did not make), those provisions clearly do not allow a comparison to be made between the net interest rates applied as a consequence of subsidies granted by a particular Member and the total amount of subsidies provided by another Member. We also note that under PROEX, the interest rate equalization subsidies for regional aircraft are provided at an "across-the-board" rate of 3.8 per cent for *all* export sales transactions.¹¹⁴ That rate is fixed, and does not vary depending on the total amount of subsidies provided by another Member to its regional aircraft manufacturers. Thus, we cannot accept Brazil's argument that the export subsidies for regional aircraft under PROEX should be "permitted" because they "match" the total subsidies provided to Bombardier by the Government of Canada.

186. For all these reasons, we do not agree with the Panel's interpretation of the phrase "used to secure a material advantage in the field of export credit terms" in item (k) of the Illustrative List. We do, however, agree with the Panel's conclusion that "Brazil has failed to demonstrate the PROEX payments are not 'used to secure a material advantage in the field of export credit terms'."¹¹⁵ We, therefore, uphold the Panel's rejection of the "affirmative defence" claimed by Brazil on the basis of item (k) of the Illustrative List.

187. In so doing, we do not rule on whether the export subsidies for regional aircraft under PROEX are "the payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits". Nor do we opine on whether a "payment" within the meaning of item (k) which is not "used to secure a material advantage within the field of export credit terms" is, *a contrario*, "permitted" by the *SCM Agreement*, even though it is a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) of that Agreement. The Panel did not rule on these issues, and the lack of Panel findings on these issues was not appealed.

¹¹³Panel Report, para. 7.28.

¹¹⁴*Ibid.*, para. 2.3.

¹¹⁵*Ibid.*, para. 7.37.

IX. Recommendation of the Panel

188. Brazil appeals the Panel's recommendation that Brazil shall withdraw the export subsidies for regional aircraft under PROEX within 90 days, stating that "the Panel's conclusion that 90 days is the proper time-period is in error."¹¹⁶ Brazil argues that although Article 4.7 of the *SCM Agreement* directs a panel to specify the time-period within which a prohibited subsidy must be withdrawn, that provision does not specify a particular time-period. Brazil argues also that under Article 4.12 of the *SCM Agreement*, "except for time-periods specifically prescribed in ... Article [4], time-periods applicable under the DSU for the conduct of such disputes shall be half the time prescribed therein." Brazil maintains that Article 21.3(c) of the DSU provides that the time-period allowed for implementation of DSB rulings and recommendations "normally should not exceed 15 months, unless there are 'particular circumstances' justifying a longer or shorter period."¹¹⁷ Therefore, Brazil maintains that the Panel should have concluded that Brazil must withdraw its export subsidies within half of fifteen months, that is, within seven and one-half months, rather than within 90 days.¹¹⁸

189. Article 4.7 of the *SCM Agreement* provides:

If the measure in question is found to be a prohibited subsidy, the Panel *shall recommend* that the subsidizing Member *withdraw* the subsidy *without delay*. In this regard, the Panel *shall specify* in its recommendation the time period within which the measure must be withdrawn. (emphasis added)

190. In this case, the Panel, in examining the language of Article 4.7 of the *SCM Agreement*, considered that it was *required* to make the recommendation provided for in that Article, and, therefore, recommended that Brazil withdraw its subsidies "without delay".¹¹⁹ The Panel also determined that the requirement that Brazil withdraw its subsidies "without delay" meant that, in the circumstances of this case, Brazil shall withdraw its subsidies within 90 days.¹²⁰

191. We note that Article 4.7 of the *SCM Agreement* is listed in Appendix 2 to the DSU as a "special or additional rule or procedure" on dispute settlement. We note also that Article 4.7 contains several elements which are different from the provisions of Articles 19 and 21 of the DSU with respect to recommendations by a panel and implementation of rulings and recommendations of the DSB. For example, Article 19 of the DSU requires a panel to recommend that the Member concerned bring its measure "into conformity" with the covered agreements. In contrast, Article 4.7 of the

¹¹⁶Brazil's appellant's submission, para. 82.

¹¹⁷*Ibid.*, para. 80.

¹¹⁸Brazil's appellant's submission, para. 82.

¹¹⁹Panel Report, para. 8.4.

¹²⁰*Ibid.*, para. 8.5.

SCM Agreement requires a panel to recommend that the subsidizing Member *withdraw* the subsidy. In addition, paragraph 1 of Article 21 of the DSU requires "prompt compliance with recommendations or rulings of the DSB", and paragraph 3 of that Article allows an implementing Member "a reasonable period of time" to implement the recommendations or rulings of the DSB, where it is impracticable to comply immediately. In contrast, Article 4.7 of the *SCM Agreement* requires a panel to recommend that a subsidy be withdrawn "without delay".

192. With respect to implementation of the recommendations or rulings of the DSB in a dispute brought under Article 4 of the *SCM Agreement*, there is a significant difference between the relevant rules and procedures of the DSU and the special or additional rules and procedures set forth in Article 4.7 of the *SCM Agreement*. Therefore, the provisions of Article 21.3 of the DSU are not relevant in determining the period of time for implementation of a finding of inconsistency with the prohibited subsidies provisions of Part II of the *SCM Agreement*. Furthermore, we do not agree with Brazil that Article 4.12 of the *SCM Agreement* is applicable in this situation. In our view, the Panel was correct in its reasoning and conclusion on this issue. Article 4.7 of the *SCM Agreement*, which is applicable to this case, stipulates a time-period. It states that a subsidy must be withdrawn "without delay". That is the recommendation the Panel made.

193. Finally, we note that although Canada requested that we recommend that Brazil withdraw the export subsidies on regional aircraft under PROEX as of the date of adoption of the Appellate Body and Panel Reports¹²¹, Canada did not formally appeal this issue. Canada's request was made in its appellee's submission, and was not included in its appellant's submission. We therefore decline this request by Canada.¹²²

194. Based on our analysis above, we see no reason to disturb the Panel's recommendation that, in this case, "without delay" means 90 days and, therefore, Brazil must withdraw the export subsidies for regional aircraft under PROEX within 90 days.

¹²¹Canada's appellee's submission, para. 169.

¹²²In *United States – Gasoline*, we similarly declined to address claims of appeal made by Brazil and Venezuela in their appellees' submissions, finding that the issues were not properly appealed in accordance with the *Working Procedures*. *Supra*, footnote 110, pp. 11-12.

X. Conditional Appeal: "Maintaining" Subsidies Under Article 3.2 of the *SCM Agreement*

195. Canada makes a conditional appeal. Canada requests that, if we accept Brazil's argument and reverse the finding of the Panel that the export subsidies for regional aircraft under PROEX are "granted" at the time of issuance of the NTN-I bonds for the purposes of Article 27.4 of the *SCM Agreement*, then we should also reverse the Panel's decision not to make a finding on whether Brazil had acted inconsistently with its obligations not to "maintain" export subsidies under Article 3.2 of that Agreement.¹²³ As we have not accepted Brazil's argument and have, therefore, not reversed the finding of the Panel on when the export subsidies for regional aircraft under PROEX are "granted", it is not necessary for us to consider this conditional appeal by Canada.

XI. Findings and Conclusions

196. For the reasons set out in this Report, the Appellate Body:

- (a) upholds the ruling of the Panel that certain regulatory instruments specified in the request for the establishment of a panel, but not discussed in the consultations, were measures properly before the Panel;
- (b) upholds the finding of the Panel that, in a dispute involving a claim of violation of Article 3.1(a) of the *SCM Agreement* by a developing country Member, the complaining party has the burden of proving that the developing country Member in question has not acted in compliance with the provisions of Article 27.4 of that Agreement;
- (c) upholds the appealed findings of the Panel relating to the Panel's determination that Brazil had failed to comply with its obligations under Article 27.4 of the *SCM Agreement* to "not increase the level of its export subsidies", and, in particular, upholds the following findings of the Panel:
 - (i) that the "proper point of reference" for the purpose of determining whether a Member has increased the level of its export subsidies is actual expenditures, rather than budgeted amounts;

¹²³Canada's appellant's submission, paras. 47-57.

- (ii) that for the purposes of Article 27.4, the export subsidies for regional aircraft under PROEX should be considered to be "granted" when the NTN-I bonds are issued, rather than when the letter of commitment is issued; and

- (iii) that it is appropriate in this case to use constant dollars, rather than nominal dollars, in assessing whether Brazil has increased the level of its export subsidies; and,

therefore, upholds the overall conclusions of the Panel that Brazil has not complied with the provisions of Article 27.4 of the *SCM Agreement*, with the result that the export subsidy prohibition in Article 3.1(a) applies to Brazil;

- (d) reverses and modifies the interpretation by the Panel of the phrase "used to secure a material advantage in the field of export credit terms" in item (k) of the Illustrative List; but upholds the conclusion of the Panel that Brazil failed to demonstrate that the export subsidies for regional aircraft under PROEX are not "used to secure a material advantage in the field of export credit terms" within the meaning of item (k); and, therefore, upholds the Panel's rejection of the "affirmative defence" claimed by Brazil on the basis of item (k) of the Illustrative List;

- (e) upholds the recommendation of the Panel that Brazil shall withdraw the export subsidies for regional aircraft under PROEX within 90 days; and

- (f) in light of the finding in (c)(ii) above, makes no finding on the conditional appeal by Canada on whether the issuance of the NTN-I bonds is consistent with Brazil's obligation not to "maintain" prohibited export subsidies under Article 3.2 of the *SCM Agreement*.

197. The Appellate Body recommends that the DSB request Brazil to bring its measures found in this Report, and in the Panel Report as modified by this Report, to be inconsistent with its obligations under the *SCM Agreement* into conformity with the provisions of that Agreement. In this respect, we recall that we uphold the recommendation of the Panel that Brazil shall withdraw the export subsidies for regional aircraft under PROEX within 90 days.

Signed in the original at Geneva this 23rd day of July 1999 by:

Said El-Naggar
Presiding Member

James Bacchus
Member

Claus-Dieter Ehlermann
Member