

**BRAZIL – EXPORT FINANCING PROGRAMME FOR
AIRCRAFT –
RECOURSE BY CANADA TO ARTICLE 21.5 OF THE DSU**

Report of the panel

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I. PROCEDURAL BACKGROUND

1.1 On 20 August 1999, the Dispute Settlement Body ("DSB") adopted the Appellate Body Report in WT/DS46/AB/R, and the Panel Report in WT/DS46/R as modified by the Appellate Body Report, in the dispute *Brazil – Export Financing Programme for Aircraft* ("*Brazil – Aircraft*").

1.2 The DSB recommended that Brazil bring its export subsidies found in the Appellate Body Report, and in the Panel Report as modified by the Appellate Body report, to be inconsistent with Brazil's obligations under Articles 3.1(a) and 3.2 of the *Agreement on Subsidies and Countervailing Measures* ("*SCM Agreement*") into conformity with its obligations under that Agreement. The DSB further recommended that Brazil withdraw the export subsidies for regional aircraft within 90 days.

1.3 On 19 November 1999, Brazil submitted to the Chairman of the DSB, pursuant to Article 21.6 of the Dispute Settlement Understanding ("DSU"), a status report (WT/DS46/12) on implementation of the Appellate Body's and the Panel's recommendations and rulings in the dispute. The status report described measures taken by Brazil which, in Brazil's view, implemented the DSB's recommendation to withdraw the measures within 90 days.

1.4 The status report indicated that the interest rate equalisation payments under PROEX would be granted only to the extent that the net interest rate applicable to a transaction under that programme was brought down to the appropriate international market "benchmark". The implementing legislation included: (i) a Resolution by the National Monetary Council altering its own Resolution 2576 dated 17 December 1998, which establishes the criteria applicable to PROEX interest rate equalisation payments; and (ii) a Central Bank Circular Letter which establishes new maximum equalisation percentages and revokes Circular Letter 2843 dated 25 March 1999.

1.5 On 23 November 1999, Canada submitted a communication to the Chairman of the DSB (WT/DS46/13), seeking recourse to Article 21.5 of the DSU. In that communication, Canada indicated that there was a disagreement between Canada and Brazil as to whether the measures taken by Brazil to comply with the 20 August 1999 rulings and recommendations of the DSB in fact bring Brazil into conformity with the provisions of the *SCM Agreement* and result in the withdrawal of the export subsidies to regional aircraft under PROEX and Canada, therefore, requested that the DSB refer the matter to the original panel, pursuant to Article 21.5 of the DSU. Canada attached the terms of an agreement reached by Canada and Brazil concerning the procedures to be followed pursuant to Articles 21 and 22 of the DSU.

1.6 At its meeting on 9 December 1999, the DSB decided, in accordance with Article 21.5 of the DSU, to refer to the original panel the matter raised by Canada in document WT/DS46/13. At that DSB meeting, it also was agreed that the Panel should have standard terms of reference as follows:

"To examine, in the light of the relevant provisions of the covered agreements cited by Canada in document WT/DS46/13, the matter referred to the DSB by Canada in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."

1.7 The Panel was composed as follows:

Chairperson: Dr. Dariusz Rosati

Members: Prof. Akio Shimizu

Mr. Kajit Sukhum

1.8 Australia, the European Communities and the United States reserved their rights to participate in the Panel proceedings as third parties.

1.9 The Panel met with the parties on 3-4 February 2000. It met with the third parties on 4 February 2000.

1.10 The Panel submitted its interim report to the parties on 31 March 2000. On 7 April 2000, Brazil submitted a written request that the Panel review precise aspects of the interim report. Neither party requested an interim meeting. The Panel submitted its final report to the parties on 28 April 2000.

II. FACTUAL ASPECTS

2.1 As described in our original Panel Report,¹ PROEX was created by the Government of Brazil on 1 June 1991 by Law No. 8187/91 and is currently being maintained by provisional measures issued by the Brazilian government on a monthly basis.² PROEX provides export credits to Brazilian exporters either through direct financing or interest rate equalisation payments.³

2.2 With direct financing, the Government of Brazil lends a portion of the funds required for the transaction. With interest rate equalisation, underlying legal instruments provide that the "National Treasury grant[s] to the financing party an equalisation payment to cover, at most, the difference between the interest charges contracted with the buyer and the cost to the financing party of raising the required funds."⁴

2.3 The financing terms for which interest rate equalisation payments are made are set by Ministerial Decrees. The terms, determined by the product to be exported, vary normally from one year to ten years. In the case of regional aircraft, however, this term has often been extended to 15 years, by waiver of the relevant PROEX guidelines. The length of the financing term, in turn, determines the spread to be equalised: the payment ranges from 0.5 percentage points per annum, for a term of up to six months, to 2.5 percentage points per annum, for a term of nine years or more.⁵ The spread is fixed and does not vary depending on the lender's actual cost of funds.⁶ As discussed in Section VI of this Report, Resolution No. 2667 of 19 November 1999 provides that, in respect of regional aircraft financing, "equalisation rates shall be established on a case by case basis and at levels that may be differential, preferably based on the United States Treasury Bond 10-year rate, plus an additional spread of 0.2% per annum, to be reviewed periodically in accordance with market practices."

2.4 PROEX is administered by the *Comitê de Crédito as Exportações* ("Committee"), a 13-agency group, with the Ministry of Finance serving as its executive. Day-to-day operations of PROEX are conducted by the Banco do Brasil. For applications for financing transactions not exceeding US\$5 million, whose terms otherwise fall within PROEX guidelines, Banco do Brasil has pre-approved authority to provide PROEX support without requesting the approval of the Committee. All other applications are referred to the Committee, which has the authority to waive some of the published PROEX guidelines. In the case of regional aircraft, the most frequent waiver has been to extend the length of the financing term from ten to fifteen years.

¹ *Brazil – Export Financing Programme for Aircraft* ("Brazil- Aircraft"), Report of the Panel ("original Panel Report") adopted on 20 August 1999, WT/DS46/R, paras. 2.1-2.6.

² As of the date of Canada's request for the matter of implementation to be referred to the original panel, the relevant legal instrument was Provisional Measure 1892-33 of 23 November 1999.

³ Law No. 8187 of 1 June 1991, replaced by Provisional Measure No. 1629 of 12 February 1998.

⁴ See, for example, Resolution No. 2380 of 25 April 1997.

⁵ See Central Bank of Brazil Circular Letter No. 2881 of 19 November 1999.

⁶ *Evaluation of the Brazilian Export Program* ("Finan Report") p. 2.7.

2.5 PROEX involvement in aircraft financing transactions begins when the manufacturer requests a letter of commitment from the Committee prior to conclusion of a formal agreement with the buyer. This request sets forth the terms and conditions of the proposed transaction. If the Committee approves, it issues a letter of commitment to the manufacturer. This letter commits the Government of Brazil to providing support as specified for the transaction provided that the contract is entered into according to the terms and conditions contained in the request for approval, and provided that it is entered into within a specified period of time, usually 90 days (and provided the aircraft is exported, as explained below). If a contract is not entered into within the specified time, the commitment contained in the letter of approval expires.

2.6 PROEX interest rate equalisation payments, pursuant to the commitment, begin after the aircraft is exported and paid for by the purchaser. PROEX payments are made to the lending financial institution in the form of non-interest-bearing National Treasury Bonds (*Notas do Tesouro Nacional – Série I*), referred to as NTN-I bonds. The bonds are issued by the Brazilian National Treasury to its agent bank, Banco do Brasil, which then passes them on to the lending banks financing the transaction. The bonds are issued in the name of the lending bank which can decide to redeem them on a semi-annual basis for the duration of the financing or discount them for a lump sum in the market. PROEX resembles a series of zero-coupon bonds which mature at six-month intervals over the course of the financing period. The bonds can only be redeemed in Brazil and only in Brazilian currency at the exchange rate prevailing at the time of payment. If the lending bank is outside of Brazil, it may appoint a Brazilian bank as its agent to receive the semi-annual payments on its behalf.

III. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES

3.1 **Canada** requests that the Panel find that Brazil's measures are not in compliance with the recommendations and rulings of the DSB in that, *first*, Brazil continues to pay export subsidies committed on exports of regional aircraft not yet granted as of 18 November 1999; and, *second*, Brazil has failed to implement measures that would bring the PROEX export subsidy programme into conformity with the *SCM Agreement*, because: (a) PROEX payments continue to constitute prohibited export subsidies, (b) the first paragraph of item (k) of the Illustrative List of Export Subsidies, Annex I, *SCM Agreement* ("Illustrative List"), does not give rise to an *a contrario* exception, and (c) even if item (k) were considered to give rise to an *a contrario* exception, PROEX export subsidies are not "payments" of the kind referred to in the first paragraph of item (k) and PROEX export subsidies under the revised programme would continue to "secure a material advantage" in the field of export credit terms. Canada further requests that the Panel suggest, in accordance with Article 19.1 of the DSU, that the parties develop verification procedures so as to permit verification that future Brazilian financing of exported regional aircraft conforms with the *SCM Agreement* without the need for further recourse to the DSU.

3.2 **Brazil** requests the Panel to reject Canada's claims in their entirety, and find that Brazil is in full compliance with all of its obligations under the *SCM Agreement*, as interpreted by the Panel and the Appellate Body, with regard to PROEX interest rate equalisation payments for regional aircraft.

IV. ARGUMENTS OF THE PARTIES AND THIRD PARTIES

4.1 The Panel has decided, with the agreement of the parties, that in lieu of the traditional descriptive part of the Panel report setting forth the arguments of the parties, the parties' submissions will be annexed in full to the Panel's report. Accordingly, the submissions of Canada are set forth in Annex 1, and the submissions of Brazil are set forth in Annex 2. In addition, the submissions of the third parties – the European Communities and the United States – are set forth in Annex 3. Australia made neither a written nor an oral submission.

4.2 In addition, both parties have incorporated by reference their arguments in the original dispute with reference to whether the first paragraph of item (k) of the Illustrative List may be used to

establish that an export subsidy is "permitted" and whether payments under PROEX are "payments" within the meaning of the first paragraph of item (k) of the List.⁷

V. INTERIM REVIEW

5.1 Canada did not provide any comments on the interim report of the Panel.

5.2 Brazil submitted the following comments. Brazil notes that, in paragraph 6.41, *infra*, the Panel states that it does not appear that Brazil argued that its *a contrario* interpretation of paragraph 1 of item (k) of the Illustrative List applied even when the subsidies "do not fall within the scope of footnote 5". Brazil states that it does not recall confining its interpretation of item (k) to the "scope of footnote 5", and certainly did not intend to do so. In this regard, Brazil notes that, in response to a question from the Panel, Brazil stated, "Footnote 5 to the SCM Agreement makes clear that the List has a purpose other than pure illustration."⁸ Beyond this, Brazil submits, the response deals with the text of item (k), not the scope of footnote 5.

5.3 With reference to Brazil's argument that its interpretation of item (k) was not confined to the scope of footnote 5, we note that, in the original dispute, Brazil's arguments appeared to evolve over time.⁹ In Brazil's first submission in the original dispute, the focus of Brazil's arguments was not on footnote 5.¹⁰ However, in its second submission in the original dispute, Brazil argued that the "material advantage" clause fell within the scope of footnote 5.¹¹ Brazil has not, however, limited its arguments regarding the interpretation of item (k) to the scope of footnote 5, and we have, therefore, made appropriate modifications to paragraph 6.41 of this Report. In any event, as we have indicated in paragraph 6.41, we consider that footnote 5 controls the interpretation of item (k) with respect to when the Illustrative List can be used to demonstrate that a measure is not a prohibited export subsidy.

5.4 Brazil also notes that, in paragraph 6.53 of this Report, the third sentence begins, "Because *banks* in many cases have a lower cost of borrowing than the governments of developing countries . . ." (Emphasis added by Brazil). Brazil argues that, if banks were the only actors in the market for aircraft financing, Brazil would not need to provide interest rate support for Embraer's transactions. It is the fact that *governments* (Emphasis added by Brazil) – particularly Canada through its Export Development Corporation – are able to offer potential customers financing support on terms that are more attractive than the terms offered by banks that requires Brazil to act.

5.5 In respect of Brazil's comments regarding the Panel's reference to the cost of borrowing of banks, the Panel wishes to point out that paragraph 6.53 of this Report represents a discussion of the way in which developing-country governments can utilise commercial lenders rather than provide direct export credit financing. The Panel in fact paraphrases Brazil's own arguments as to the relative cost of different modalities of providing export credits.¹² In that context, it is clear that utilising commercial lenders would be less expensive than providing direct financing, because the government can take advantage of the lower cost of borrowing enjoyed by commercial lenders. Footnote 53 is merely an illustration of this fact. Paragraph 6.53 is in no sense intended to suggest that Brazil argues that it provides PROEX interest rate equalisation in order to meet competition from export credit financing provided by commercial banks. We have, therefore, made appropriate modifications to paragraph 6.53 of this Report.

⁷ Original Panel Report, paras. 4.53-4.71 and paras. 4.72-4.78, respectively.

⁸ See Response of Brazil to Question 10 from the Panel, *infra*, Annex 2-4, p. 133.

⁹ As indicated in para. 4.2, *supra*, Brazil has incorporated by reference its arguments in the original dispute regarding whether the first paragraph of item (k) of the Illustrative List may be used to establish that an export subsidy is "permitted". See Response of Brazil to Further Question 1 from the Panel, *infra*, Annex 2-4, p. 137.

¹⁰ See original Panel Report, paras. 4.53-4.54.

¹¹ *Ibid*, at para. 4.67.

¹² See Oral Statement of Brazil, paras. 11-20, *infra*, Annex 2-3, p. 115.

VI. FINDINGS

A. INTRODUCTION AND CLAIMS OF CANADA

6.1 This dispute under Article 21.5 of the DSU concerns a disagreement between Canada and Brazil as to the existence or consistency of measures taken by Brazil to comply with the recommendation of the DSB pursuant to Article 4.7 of the *SCM Agreement* that Brazil withdraw export subsidies for regional aircraft under PROEX without delay.¹³

6.2 In the dispute ("original dispute") giving rise to this Article 21.5 dispute, the Panel found that the prohibition on export subsidies in Article 3.1(a) of the *SCM Agreement* applied to Brazil because Brazil had failed to comply with certain of the conditions of Article 27.4 of that Agreement. The Panel further found that PROEX payments were subsidies contingent upon export performance within the meaning of Article 3.1(a). Finally, the Panel rejected Brazil's defence that PROEX payments were "permitted" because they were "payments" within the meaning of the first paragraph of item (k) which were not "used to secure a material advantage in the field of export credit terms". The Panel found that, *assuming* that the first paragraph of item (k) could be used to establish that a subsidy that is contingent upon export performance was "permitted", and that PROEX payments were "payments" within the meaning of that paragraph, Brazil had failed to establish that PROEX payments were not "used to secure a material advantage in the field of export credit terms". Accordingly, the Panel requested that the DSB recommend that Brazil withdraw the prohibited subsidies without delay. The Appellate Body modified certain aspects of the Panel's reasoning but upheld the Panel's conclusions as stated above.

6.3 In this Article 21.5 dispute, Canada raises two issues regarding the existence or consistency with the *SCM Agreement* of measures taken by Brazil to comply with the recommendation of the DSB.

First, Canada contends that Brazil cannot, consistent with the recommendation of the DSB, continue to issue NTN-I bonds pursuant to letters of commitment issued under PROEX as it existed prior to the end of the implementation period, *i.e.*, 18 November 1999. Brazil responds that the DSB's recommendation to withdraw the prohibited subsidy does not require it to cease issuing NTN-I bonds pursuant to such pre-existing letters of commitment.

Second, Canada contends that payments in respect of regional aircraft pursuant to PROEX as modified by Brazil continue to be subsidies contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement* and thus prohibited. Brazil responds that under PROEX as modified payments no longer are "used to secure a material advantage in the field of export credit terms" and therefore are "permitted" by the *SCM Agreement*.

We will take up each of these issues in turn.

B. MAY BRAZIL CONTINUE TO ISSUE NTN-I BONDS PURSUANT TO LETTERS OF COMMITMENT ISSUED UNDER PROEX AS IT EXISTED BEFORE 18 NOVEMBER 1999?

6.4 Canada claims that Brazil has failed to withdraw the export subsidies for regional aircraft under PROEX, because it continues to grant, through the issuance of NTN-I bonds, PROEX subsidies found to constitute prohibited export subsidies pursuant to commitments made prior to

¹³ *Brazil Aircraft*, Report of the Appellate Body ("Appellate Body Report") adopted on 20 August 1999, WT/DS46/AB/R, para. 197.

18 November 1999, the date by which Brazil was required to withdraw the export subsidies in question. Brazil considers that, in fulfilling its pre-18 November 1999 commitments through the issuance of NTN-I bonds after that date upon the export of regional aircraft, it is "not creating new subsidies"¹⁴ and therefore not acting in a manner inconsistent with its obligations under the *SCM Agreement*.

6.5 Canada notes that Brazil is required to withdraw the prohibited export subsidies, and submits that the word "withdraw", in its plain meaning, conveys as a minimum the notion of ceasing to grant or maintain the illegal subsidies. Article 3.2 of the *SCM Agreement* provides that a Member shall not "grant or maintain" prohibited subsidies. Canada recalls that the Appellate Body had found that PROEX subsidies are granted for the purposes of Article 27.4 of the *SCM Agreement* when Brazil issues NTN-I bonds. There is no reason in Canada's view to interpret the word "grant" differently for the purposes of Article 3.2 than for the purposes of Article 27.4. Accordingly, Brazil must, in Canada's view, cease issuing NTN-I bonds in respect of pre-18-November-1999 letters of commitment.

6.6 In Brazil's view, Canada has confused the finding of the Appellate Body as to when PROEX subsidies are granted for the purposes of Article 27.4 of the *SCM Agreement* with the issue of when PROEX subsidies come into existence within the meaning of Article 1 of that Agreement. Brazil considers that under Article 1 a subsidy shall be deemed to exist when there is a financial contribution by a government and a benefit is thereby conferred. In the case of PROEX subsidies, the benefit arises when Brazil makes a legally binding commitment to provide PROEX support.¹⁵ Because the financial contribution must logically precede or coincide with the benefit, the financial contribution must be in the form of a potential direct transfer of funds. In the view of Brazil, an interpretation of Article 1 that resulted in the conclusion that PROEX subsidies come into existence only when aircraft are exported would render whole clauses of Part III of the *SCM Agreement* ("Actionable Subsidies") a nullity because, although the impact of PROEX on the domestic industry of a competitor would be felt when Embraer obtains an order, no subsidy would exist and thus no countervailing measure be possible until the aircraft was exported. Finally, Brazil argues that it is legally obligated to issue bonds pursuant to letters of commitment issued prior to the date of implementation of the DSB's recommendations or be subject to damages for breach of contract.

6.7 In considering this issue, we first note that Brazil does not deny that it continues to issue NTN-I bonds in respect of commitments made prior to 18 November 1999. Further, Brazil has stated, in response to a question from the Panel, that Resolution 2667 does not modify pre-existing PROEX commitments pertaining to aircraft to be exported after 22 November 1999, the date of publication of Resolution 2667.¹⁶ We recall that, in the original dispute, the Panel found that PROEX payments on exports of Brazilian regional aircraft were export subsidies prohibited by Article 3.1(a) of the *SCM Agreement*. This finding was upheld by the Appellate Body. We also recall that the DSB recommended, pursuant to Article 4.7 of the *SCM Agreement*, that Brazil "withdraw the [export] subsidies . . . without delay".

6.8 The issue Canada has put before us is whether the continued issuance of NTN-I bonds in respect of commitments entered into prior to 18 November 1999, on terms found by the Panel and the Appellate Body to give rise to a prohibited export subsidy, is inconsistent with Brazil's obligation to withdraw the export subsidies in question. Thus, we need not for the purposes of this dispute develop a comprehensive understanding of the scope of the obligation to "withdraw" a prohibited subsidy. Rather, it suffices to conclude – and Brazil does not contest – that a Member cannot be deemed to

¹⁴ Second Submission of Brazil, para. 3.

¹⁵ In the early phases of this proceeding, Brazil stated that the subsidy comes into existence when the letter of commitment is issued. Subsequently, Brazil clarified that in its view the subsidy exists when a sales contract is signed pursuant to a letter of commitment. Response of Brazil to Question 12 of the Panel.

¹⁶ Response of Brazil to Question 4 of the Panel.

have withdrawn prohibited subsidies if it has not ceased to act in a manner inconsistent with the *WTO Agreement* in respect of those subsidies. We are therefore of the view that the DSB's recommendation that Brazil withdraw the prohibited subsidies in question clearly includes an obligation on the part of Brazil to cease violating the *SCM Agreement* by the end of the implementation period in respect of the measures in question.¹⁷

6.9 Article 3.2 of the *SCM Agreement* provides as follows:

"A Member shall neither grant nor maintain 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]."

It follows that the continuing granting or maintaining of prohibited export subsidies after the end of the implementation period would be inconsistent with Brazil's obligation to withdraw those subsidies. Accordingly, we must consider whether the continued issuance of NTN-I bonds by Brazil pursuant to letters of commitment issued under PROEX prior to its modification constitutes the "grant" of prohibited export subsidies within the meaning of Article 3.2 of the *SCM Agreement*.

6.10 In the original dispute, we held that, for the purposes of Article 27.4, export subsidies for regional aircraft under PROEX are "granted" for the purposes of calculating the level of Brazil's export subsidies under Article 27.4 of the *SCM Agreement* when the NTN-I bonds are issued. Brazil appealed this finding. The Appellate Body confirmed our holding, finding that:

"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 occurred.' We also agree with the Panel that the export subsidies . . . 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. For the purposes of Article 27.4, we conclude that the export subsidies . . . 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."¹⁸

6.11 We note that Article 3.2 and Article 27.4 are provisions of the same Agreement. Further, both provisions relate to the prohibition on export subsidies set out under that Agreement. We do not perceive any basis to attribute to the term "grant" as used in Article 3.2 of the *SCM Agreement* a

¹⁷ We are aware that a panel established under Article 21.5 of the *DSU* recently found that a recommendation to "withdraw" a prohibited subsidy under Article 4.7 of the *SCM Agreement* "is not limited to prospective action only but may encompass repayment of the prohibited subsidy." *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, Recourse to Article 21.5 of the *DSU* by the United States, Report of the Panel adopted on 11 February 2000, WT/DS126/RW, para. 6.39. In that dispute, which involved one-time subsidies paid in the past whose retention was not contingent upon future export performance, the United States as complainant argued that the "prospective portion" of the subsidy granted by Australia, *i.e.*, \$A26 million out of a total grant of \$A30 million, had to be repaid. In this dispute, Canada has not claimed that the non-repayment, in whole or in part, of subsidies granted by Brazil represents a failure to "withdraw" the prohibited export subsidies in question. We recall that, under Article 3.7 of the *DSU*, the aim of the dispute settlement mechanism is to secure a positive resolution to a dispute, and that our role under Article 21.5 is to render a decision "where there is disagreement" as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations or rulings of the DSB. Accordingly, we shall address only claims that are put before us. Our silence on issues that are not before us should not be taken as expressing any view, express or implied, as to whether or not a recommendation to "withdraw" a prohibited subsidy may encompass repayment of that subsidy.

¹⁸ Appellate Body Report, para. 158.

meaning different from that attributed to that term by this Panel and the Appellate Body as used in Article 27.4 of the *SCM Agreement*. It follows that the issuance of NTN-I bonds by Brazil constitutes the granting of export subsidies within the meaning of Article 3.2.

6.12 Brazil urges the Panel to consider the issue of when a subsidy may be deemed to exist under Article 1 of the *SCM Agreement*, and the form of the financial contribution involved, when deciding when PROEX subsidies are granted for the purposes of Article 3.2. Thus, Brazil states, in response to a question from the Panel, that:

"... a financial contribution is made and a benefit is conferred within the meaning of Article 1 of the *SCM Agreement*, and a subsidy is thereby granted within the meaning of Article 3.2 of the *SCM Agreement*, when contracts are signed pursuant to letters of commitment." (emphasis added)

6.13 We recall however that the Panel, in order to respond to the question of when PROEX payments should be considered to have been granted for the purposes of Article 27.4 in the original dispute, also focused on the language of Article 1 of the *SCM Agreement*. The Appellate Body held, however, held this to be error:

"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 and when the subsidy "exists", within the meaning of Article 1.1 of that Agreement."(emphasis in original.)¹⁹

The Appellate Body further explained that:

"[T]he issue before the Panel under the heading 'Has Brazil increased the level of its export subsidies?' 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... [F]or 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 (emphasis in original). Only one of those issues is raised here and, therefore, must be addressed".²⁰

6.14 We recognize that the distinction made by the Appellate Body was between the existence of a subsidy and when a subsidy is granted related to when a subsidy is granted *for the purposes of Article 27.4* of the *SCM Agreement*, and not when it was granted *for the purposes of Article 3.2*. As a matter of logic, however, we cannot perceive – nor has Brazil identified – any basis for us to conclude that, while the existence of a subsidy is a legally distinct issue from when it is granted for the purposes of Article 27.4, it is *not* a legally distinct issue from when it is granted for the purposes of Article 3.2. In other words, if the issue of when a subsidy is "granted" *for the purposes of Article 27.4* is legally distinct from when it "exists" for the purposes of Article 1, then it follows that the issue of when a subsidy is granted *for the purposes of Article 3.2* is also legally distinct from the issue when it exists for the purposes of Article 1. Accordingly, we decline Brazil's invitation to consider when

¹⁹ Appellate Body Report, para. 154.

²⁰ Appellate Body Report, para. 156.

the subsidy "exists" within the meaning of Article 1 when examining when the subsidy is "granted" for the purpose of Article 3.2.²¹

6.15 Brazil contends that requiring Brazil to cease issuing NTN-I bonds pursuant to commitments made prior to 18 November 1999 amounts to a retroactive remedy. We cannot agree. In our view, the obligation to cease performing illegal acts in the future is a fundamentally prospective remedy.²²

6.16 Nor are we convinced that a different interpretation is required because Brazil asserts that it has a contractual obligation to issue PROEX bonds pursuant to commitments already entered into, and that it would be liable to damages for breach of contract if it failed to do so. Assuming that Brazil is correct in this regard,²³ the implication of this view would be that Members could contract to grant prohibited subsidies for years into the future and be insulated from any meaningful remedy under the WTO dispute settlement system. Nor is this a purely hypothetical situation. If Canada's figures are correct – and Brazil has not disputed their overall accuracy – Brazil has outstanding commitments to issue NTN-I bonds pursuant to PROEX as it existed before modification in respect of nearly 900 regional aircraft that have yet to be exported. Letters of commitment in respect of some 300 regional aircraft were issued after the Panel Report in the original dispute was circulated to Members on 14 April 1999. By Brazil's reasoning, it should be allowed to continue issuing bonds upon the exportation of these aircraft for years to come.

6.17 For all of the reasons set forth above, we conclude that the continued issuance of NTN-I bonds pursuant to letters of commitment issued prior to 18 November 1999 represents the granting of subsidies contingent upon export performance within the meaning of Article 3.2 of the *SCM Agreement*. Accordingly, we conclude that in this respect Brazil has failed to implement the recommendation of the DSB that it withdraw the export subsidies for regional aircraft under PROEX within 90 days.

C. ARE PAYMENTS PURSUANT TO THE PROEX SCHEME AS MODIFIED BY BRAZIL CONSISTENT WITH THE *SCM AGREEMENT*?

6.18 In the first section of this Report, we addressed the *existence* of measures taken to comply with the recommendation of the DSB in respect of payments on exports of regional aircraft pursuant to letters of commitment issued under PROEX prior to its modification by Brazil. In this section, we address the *consistency* with the *SCM Agreement* of measures taken by Brazil to comply with the

²¹ Brazil argues that a finding that a subsidy within the meaning of Article 1 of the *SCM Agreement* does not exist until NTN-I bonds are issued would render provisions of Part III of the Agreement ineffective. Because our finding regarding when PROEX subsidies are "granted" within the meaning of Article 3.2 does not imply a view as to when PROEX subsidies "exist", we need not further address the issue raised by Brazil.

²² Cf., *Vienna Convention on the Law of Treaties*, Article 28. This provision, entitled "Non-Retroactivity of Treaties", provides that, unless a different intention appears from the treaty, its provisions do not bind a party "in relation to any act or fact that took place or situation which ceased to exist" before the date of entry into force of the treaty for that party. By negative implication, it would not be retroactive application to bind a party with respect to acts that took place after a treaty entered into force. Although this article addresses the temporal application of treaties, and not of DSB recommendations, it nevertheless provides some guidance in respect of the meaning of the concept of retroactivity in public international law.

²³ A resolution of the question whether Brazil would be liable to damages for breach of contract for failure to issue NTN-I bonds in respect of existing commitments would require consideration not only of Brazilian administrative and contract law, but also of the role of the *WTO Agreement* in Brazil's domestic legal system. See Response of Brazil to Question 12 of the Panel. Although a Panel may examine municipal law in order to determine whether a Member has complied with the *WTO Agreement*, (See, e.g., *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, Report of the Appellate Body adopted on 16 January 1998, WT/DS50/AB/R, para. 66), we are reluctant to enter into such an examination here, as the issues are complex, not fully briefed, and ultimately not essential to our resolution of the case at hand. In any event, we recall that, under Article 27 of the *Vienna Convention on the Law of Treaties*, a party to a treaty may not invoke the provisions of its internal law as justification for its failure to perform a treaty.

recommendation of the DSB in respect of payments on exports of regional aircraft pursuant to letters of commitment issued under PROEX after its modification by Brazil.

1. Steps taken by Brazil to comply with the recommendation of the DSB

6.19 The basic language authorising PROEX interest rate equalisation, found in Provisional Measure 1892-33, has not changed since the date of establishment of the original panel in this dispute.²⁴ Brazil however argues that it has implemented the DSB's recommendation in this dispute through Resolution 2667 of 19 November 1999.²⁵ Article 1 of the Resolution repeats the basic standard of Provisional Measure 1892-33 that the National Treasury may grant equalisation sufficient "to ensure that the relevant financial charges are consistent with standard practices on the international market." Article 1 further provides that:

"Paragraph 1. In the financing of aircraft exports for regional aviation markets, equalisation rates shall be established on a case by case basis and at levels that may be differential, preferably based on the United States Treasury Bond 10-year rate, plus an additional spread of 0.2% per annum, to be reviewed periodically in accordance with market practices.

Paragraph 2. The equalisation rate shall be limited to the percentages established by the Central Bank of Brazil, and shall remain fixed throughout the period in question."

6.20 As discussed in paras. 6.75-6.77, *infra*, Brazil considers that, as a result of this Resolution, PROEX payments are no longer used to secure a material advantage in the field of export credit terms and are hence "permitted" by the first paragraph of item (k) of the Illustrative List.

2. Assessment of the Panel

6.21 In the original dispute, we found that Brazil had failed to comply with certain conditions of Article 27.4 of the *SCM Agreement*, and that the prohibition of Article 3.1(a) of the *SCM Agreement* was therefore applicable to Brazil.²⁶ The Appellate Body sustained this finding on appeal.²⁷ Brazil has not suggested before this Article 21.5 Panel that this situation has changed in any respect. Accordingly, we conclude that Article 3.1(a) continues to apply to Brazil. We further found, and Brazil did not dispute, that PROEX payments are subsidies within the meaning of Article 1 of the *SCM Agreement* that are contingent upon export performance within the meaning of Article 3.1(a) of that Agreement. This finding was not appealed, nor has Brazil suggested that Resolution 2667 in any way affects the status of PROEX payments as export subsidies.

²⁴ Provisional Measure 1892-33 of 23 November 1999 and Provisional Measure 1700-15 of 30 June 1998 both provide in Article 2 that, "[i]n operations to finance the export of domestic goods and services not covered by the preceding article and in financing for the production of goods for export, the National Treasury may grant the financing entity equalisation funding sufficient to make the financing charges consistent with practices on the international market."

²⁵ Canada Documentary Annex 5, Exhibit Bra-1. Brazil informed the DSB that it had implemented its recommendation through two pieces of "implementing legislation", Resolution 2667 and Circular Letter 2881 of 19 November 1999 published by the Central Bank of Brazil. Circular Letter 2881 establishes "the maximum percentages that may be applied under tax rate equalisation systems used for PROEX operations." These maximum percentages cover financing for up to ten years, with the highest interest rate equalisation rate set at 2.5 per cent for financing of "over 9 years and up to 10 years", down from 3.8 per cent previously. In the First Submission of Brazil, however, Brazil indicated that Circular Letter 2881 represents "an additional action that does not directly affect the question before this Panel". From this we conclude that Brazil does not assert that Circular Letter 2881 is relevant to our consideration whether PROEX as modified is consistent with the *SCM Agreement*.

²⁶ Original Panel Report, para. 8.1.

²⁷ Appellate Body Report, para. 164.

6.22 Brazil does however assert that PROEX payments are "payments" within the meaning of the first paragraph of item (k) of the Illustrative List which are not "used to secure a material advantage in the field of export credit terms" and which are therefore "permitted". Thus, Brazil's defence in this dispute depends upon the proposition that the first paragraph of item (k) may be used to establish that an export subsidy within the meaning of item (k) is "permitted" by the *SCM Agreement*. It further depends upon Brazil establishing that (a) PROEX payments are "payments" within the meaning of item (k); and (b) PROEX payments are not "used to secure a material advantage in the field of export credit terms". Further, Brazil has acknowledged that it is asserting an affirmative defence, and that the burden of establishing entitlement to it is thus on Brazil.²⁸

6.23 We note that, in the original dispute, this Panel restricted itself to a finding that PROEX payments *were* used to secure a material advantage in the field of export credit terms. We did not address the two other elements necessary to Brazil's defence, *i.e.*, whether the first paragraph of item (k) can be used to establish that an export subsidy is "permitted", and whether PROEX payments are "payments" within the meaning of item (k). Nor did the Appellate Body make findings on these issues. In this Article 21.5 dispute, however, we have decided to address all three elements of Brazil's defence. In our view, this more comprehensive approach will provide a greater degree of clarity and guidance to the parties in respect of implementation. It also facilitates a better understanding of the relevant provisions in the context of the broader operation of the *SCM Agreement*.

(a) May the first paragraph of item (k) be used to establish that an export subsidy is "permitted"?

6.24 The first paragraph of item (k) of the Illustrative List identifies as an export subsidy:

"The grant by governments (or special institutions controlled by 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.*" (emphasis added).

6.25 As noted above, Brazil's "material advantage" defence is predicated on the proposition that payments within the meaning of the first paragraph of item (k) that are *not* "used to secure a material advantage in the field of export credit terms" are "permitted" by the *SCM Agreement*.²⁹ Accordingly, we will first consider whether, as a matter of law, the first paragraph of item (k) can be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) is nevertheless "permitted", or whether, as argued by Canada, the first paragraph of item (k) cannot be used in this manner.

(i) *Has this issue already been addressed by the Appellate Body?*

6.26 In considering this question, we first observe that this issue has *not* been decided, either by the Panel or by the Appellate Body, in the original dispute. To the contrary, both the Panel and the Appellate Body specifically declined to rule on this issue. In the words of the Appellate Body:

"Nor do we opine on whether 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, *a contrario*, 'permitted' by the *SCM Agreement*, even though it is a subsidy which is contingent

²⁸ Original Panel Report, para. 7.17.

²⁹ First Submission of Brazil, para. 4 ("The Appellate Body, noted, however, that Members are permitted to obtain an 'advantage' in the field of export credit terms, provided that advantage is not material").

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."³⁰

6.27 Nor do we accept Brazil's contention that we should infer some implicit finding on this issue by the Appellate Body. The fact that the Appellate Body considered and decided the issue of whether PROEX payments are used to "secure a material advantage in the field of export credit terms" does not mean that the Appellate Body accepted (nor, for that matter, that it rejected) Brazil's view that the first paragraph of item (k) can be used to establish that an export subsidy is "permitted". We decline to speculate about how the Appellate Body might have resolved this issue had it been before it. Rather, we will make our finding on this issue on the basis of the *SCM Agreement* as interpreted in accordance with customary rules of public international law.

(ii) *The relationship between Article 3.1(a) and the Illustrative List of Export Subsidies*

6.28 In examining whether the first paragraph of item (k) can be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) is nevertheless "permitted", our starting point is of course the text of the *SCM Agreement*. In this respect, and turning first to the text of Article 3.1(a), we note that that Article states that:

"Except as provided in the Agreement on Agriculture, the following subsidies within the meaning of Article 1, shall be prohibited:

(a) Subsidies contingent [footnote omitted], in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I⁵;

.....

⁵ Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

6.29 Leaving aside for the moment the issue of the role of footnote 5 – an issue to which we will return shortly – we consider that two conclusions can be derived from the text of Article 3.1(a).

6.30 *First*, Annex I is purely illustrative, *i.e.*, it does not purport to be an exhaustive list of export subsidies. In other words, it contains examples of prohibited export subsidies. It is clear, however, that it is legally possible – and, as a matter of fact, highly likely – that there are prohibited export subsidies within the meaning of Article 3.1(a) that do not fall within the scope of Annex I. Should there be any doubt on this score – and neither the parties nor the third parties have expressed any such doubt – this conclusion is borne out by the title given to Annex I, to wit, "Illustrative List of Export Subsidies".

6.31 *Second*, a measure that falls within the scope of the Illustrative List is *deemed* to be a prohibited export subsidy. In other words, a Member may establish that a measure is a prohibited export subsidy by going directly to the Illustrative List, without first demonstrating that a measure falls within the scope of Article 3.1(a). This is confirmed from the words "subsidies contingent . . . upon export performance, *including* those illustrated in Annex I" (emphasis added), which in their ordinary meaning tell us that measures identified in the Annex are *ipso facto* "subsidies contingent upon export performance".

³⁰ Appellate Body Report, para. 187.

6.32 There is however a third conclusion that we cannot draw from the text of Article 3.1(a). Canada argues that a finding that the Illustrative List could be used *a contrario* to establish that measures were "permitted", would turn the Illustrative List into an exhaustive list. We do not agree. Rather, another possible interpretation is that offered by Brazil but perhaps expressed most clearly by the United States as third party:

"The Illustrative List does not deal with all possible financial contributions, but for those it does deal with, it establishes, by virtue of footnote 5, a dispositive legal standard insofar as prohibited subsidies are concerned."³¹

Without necessarily agreeing with the US interpretation of the role of the Illustrative List – as our subsequent discussion will clearly demonstrate – we do not consider that we can conclude, based on the mere fact that the Illustrative List is "illustrative", that the List cannot be used *a contrario*.

(iii) *The role of footnote 5 to the SCM Agreement*

6.33 How thus may we resolve the question whether and under what conditions the Illustrative List can be used to demonstrate that a subsidy which is contingent upon export performance is *not* prohibited, *i.e.*, that it is "permitted"? One possibility would be to resort to general interpretive techniques. Thus, it could be argued that the Panel should interpret the Illustrative List *a contrario sensu*, a term defined as meaning "on the other hand; in the opposite sense",³² or should apply the principle of *lex specialis*. For the reasons discussed below, however, we need not rely on such general principles in this case.

6.34 The drafters of the *SCM Agreement* must have recognized that the insertion of the Illustrative List of Export Subsidies – which was imported with only minor modifications from the Tokyo Round *Subsidies Code* – into an Agreement that contained for the first time definitions of "subsidy" and "export subsidy" would create interpretive difficulties, as the *SCM Agreement* provides us with a specific textual basis to resolve this question. This textual basis is footnote 5 to the *SCM Agreement*.³³

Footnote 5 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".

6.35 Brazil contends that payments within the meaning of the first paragraph of item (k) that are not used to secure a material advantage in the field of export credit terms fall within the scope of this footnote. We disagree.

6.36 In its ordinary meaning, footnote 5 relates to situations where a measure is referred to as *not* constituting an export subsidy. Thus, one example of a measure that clearly falls within the scope of footnote 5 involves export credit practices that are in conformity with the interest rate provisions of the *Arrangement on Guidelines for Officially Supported Export Credits* ("Arrangement"). The second

³¹ Oral Statement of the United States at the third-party session, para. 15.

³² *Black's Law Dictionary*, Seventh Edition, West Group, 1999 at 23.

³³ The *SCM Agreement* also includes a provision governing the relationship between certain elements of the Illustrative List and Article 1 of the Agreement. Footnote 1 to the Agreement provides that, "[i]n accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties and taxes in amounts not in excess of those which have accrued, shall not be deemed to be a *subsidy*." (emphasis added). This footnote, of course, is not applicable to the situation at hand, as PROEX payments are unrelated to the exemption of an exported product from duties or taxes.

paragraph of item (k) provides that such measures "shall not be considered an export subsidy prohibited by this Agreement". Arguably, footnote 5 in its ordinary meaning could extend more broadly to cover cases where the Illustrative List contains some other form of *affirmative* statement that a measure is not subject to the Article 3.1(a) prohibition, that it is *not* prohibited, or that it is allowed, such as, for example, the first and last sentences of footnote 5³⁴ and the proviso clauses of items (h)³⁵ and (i)³⁶ of the Illustrative List.³⁷

6.37 The first paragraph of item (k), however, does not contain any affirmative statement that a measure is *not* an export subsidy nor that measures not satisfying the conditions of that item are *not* prohibited. To the contrary, the first paragraph of item (k) on its face simply identifies measures that *are* prohibited export subsidies. Thus, the first paragraph of item (k) on its face does not in our view fall within the scope of footnote 5 read in conformity with its ordinary meaning.

6.38 We recall the view of Brazil and the United States that "the Illustrative List does not deal with all possible financial contributions, but for those it does deal with, it establishes, by virtue of footnote 5, a dispositive legal standard insofar as prohibited subsidies are concerned."³⁸ In other words, we understand them to argue that, with respect to financial contributions dealt with by the Illustrative List, the List provides the sole basis to determine whether the measure is prohibited or permitted. While we agree that an illustrative list could in principle operate in such a manner, we do not consider that such an interpretation is readily supported by the text of footnote 5 itself. To the contrary, if the drafters had intended the meaning which the United States attributes to footnote 5, they could certainly have found appropriate language to do so.

6.39 The United States advances arguments based on the negotiating history of footnote 5 in support of its broad interpretation of that footnote to apply to the first paragraph of item (k). In this respect, it points out that in a Chairman's text of the *SCM Agreement* known as *Cartland III*, footnote 5 provided as follows:

"Measures *expressly* referred to as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." (emphasis added).³⁹

As the United States correctly observes, a new Chairman's text (known as "Cartland IV") was released just a few days later.⁴⁰ In that new text, the word "expressly" was dropped from the footnote, which took its present form. In the view of the United States, this change demonstrates that the drafters "intended to expand, rather than restrict" the scope of footnote 5, and that "they did not intend the sort of narrow construction of footnote 5 advanced by Canada and the EC."⁴¹

³⁴ The first sentence of footnote 59 provides that "Members recognize that deferral need not amount to an export subsidy where, for example, appropriate interest charges are collected." The last sentence states that "[p]aragraph (e) is not intended to limit a Member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member."

³⁵ ". . . provided, however, that prior-stage cumulative indirect taxes *may be* exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products sold for domestic consumption, if the prior stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product . . ." (emphasis added).

³⁶ ". . . provided, however, that in particular cases a firm *may use* a quantity of home market inputs equal to, and having the same quality and characteristics as, the imported inputs as a substitute for them . . ."

³⁷ In any event, such measures may well fall within the scope of footnote 1, and thus not represent subsidies at all, whether prohibited or otherwise.

³⁸ Oral Statement of the United States at the third-party session, para. 15.

³⁹ Draft Text by the Chairman, MTN/GNG/NG10/W/38/Rev.2, 2 November 1990.

⁴⁰ Draft Text by the Chairman, MTN/GNG/NG10/W/38/Rev.3, 6 November 1990.

⁴¹ Oral Statement of the United States at the third-party session, para. 12.

6.40 We agree with the United States that the deletion of the term "expressly" appears to have broadened the scope of footnote 5 in *Cartland IV* beyond its scope in *Cartland III*. We do not agree, however, that it served to broaden footnote 5 to the extent suggested by the United States. As we discussed above, the Illustrative List contains – and already contained at the time of *Cartland III* and *IV* – a number of provisions that include affirmative statements that arguably represent authorizations to use certain measures. The language of *Cartland III* ("expressly referred to") could have precluded asserting that footnote 5 applied to any of these provisions, and it may be that the purpose of the modification was to rectify this situation. If on the other hand the intention of the drafters in changing footnote 5 had been to extend the scope of that footnote to cover situations where the Illustrative List merely referred to things that *were* export subsidies, they might have been expected to modify the structure of the second part of the footnote, and not merely delete the word "expressly". At the very least, we conclude that the implications of the negotiating history referred to by the United States are inconclusive and cannot lead us to disregard the ordinary meaning of the footnote.

6.41 Of course, it could be argued that, based on an *a contrario* argument, the Illustrative List permits admitted export subsidies *even where those subsidies do not fall within the scope of footnote 5*. As we have already indicated, however, the drafters have provided us with a specific textual provision that addresses the issue when the Illustrative List can be used to demonstrate that a measure is not a prohibited export subsidy. The fact that this footnote was adjusted on at least one occasion suggests that the drafters gave this issue consideration and provided the answer to this question.⁴² If we were to conclude that the Illustrative List by implication gave rise to "permitted" measures beyond those allowed by footnote, we would be calling into serious question the *raison d'être* of footnote 5.

(iv) *The material advantage clause and the principle of effective treaty interpretation*

6.42 Brazil, and the United States as third party, contend that a finding that the first paragraph of item (k) cannot be used *a contrario* to permit export credits and payments that are *not* used to secure a material advantage would render the "material advantage" clause ineffective.⁴³ We do not agree. In our view, the primary role of the Illustrative List is not to provide guidance as to when measures are *not* prohibited export subsidies – although footnote 5 allows it to be used for this purpose in certain cases – but rather to provide clarity that certain measures *are* prohibited export subsidies. Thus, it would be possible to demonstrate that a measure falls within the scope of an item of the Illustrative List and was thus prohibited without being required to demonstrate that Article 3, and thus Article 1, was satisfied. To borrow a concept from the field of competition law, the Illustrative List could be seen as analogous to a list of *per se* violations. Seen in this light, the material advantage clause is not "ineffective", in the sense that it is reduced to redundancy or inutility, by a finding that the first paragraph of item (k) cannot be used *a contrario* to establish that a measure is permitted. To the contrary, the material advantage nevertheless continues to serve an important role by narrowing the range of measures that would otherwise be subject to the "*per se*" violation set forth in the first paragraph of item (k), as discussed below.

⁴² The Illustrative List was imported with only modest changes from the Tokyo Round *Agreement on Interpretation and Application of Article VI, XVI and XXIII of the General Agreement on Tariffs and Trade* ("*Subsidies Code*"). The Subsidies Code prohibited Signatories (other than developing country Signatories) from granting export subsidies on products other than certain primary products and included a list of practices that were "illustrative of export subsidies". See Articles 9 and 14.2. The *Subsidies Code* defined neither the term "subsidy" nor the term "export subsidy", and the drafters must have been aware that the importation of the List into a new agreement with groundbreaking new definitions would give rise to a need for textual clarification.

⁴³ The principle of effectiveness in the interpretation of treaties has been recognised in the WTO dispute settlement system. As the Appellate Body explained in *United States – Gasoline*, "an interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility" (*United States – Standards for Reformulated and Conventional Gasoline*, Report of the Appellate Body adopted on 20 May 1996, WT/DS2/AB/R, footnote 10, p. 23).

6.43 Let us consider the first situation envisioned by the first paragraph of item (k), the grant by governments of export credits at rates below their cost of funds. It may generally be assumed that in such circumstances there will be a benefit to the recipient and thus a subsidy. This is however not always the case. Whenever a government's cost of funds is higher than that of the borrower, a loan at below the government's cost of funds may nevertheless fail to confer a benefit on the recipient. For example, Brazil argues in this dispute that its cost of funds is in excess of 13 per cent. By contrast, it is likely that many purchasers of Brazilian exports could obtain private export credit financing, not benefiting from government intervention of any kind, at an interest rate significantly lower than 13 per cent. Thus, direct financing by Brazil in these circumstances could well entail a cost to the government but provide no advantage, material or otherwise, to the recipient. Under these circumstances, and in the absence of the material advantage clause, Brazil would be prohibited from providing export credits at an interest rate lower than 13 per cent⁴⁴, even if the export credits provided no advantage whatsoever.⁴⁵ The role of the material advantage clause in this situation is to narrow the scope of the *per se* prohibition in such cases.

6.44 A similar situation could arise in cases of payments under the first paragraph of item (k). Without the material advantage clause, a complainant could demonstrate the existence of a prohibited subsidy merely by demonstrating the existence of a payment within the meaning of item (k). However, a financial institution in a developing country may have a higher cost of funds than financial institutions in developed countries, and thus be unable to provide export credits on terms competitive with those of foreign financial institutions. A payment by Brazil that allowed a Brazilian financial institution to provide export credits to an overseas customer on precisely the same terms as that customer could have obtained in international financial markets could, absent the material advantage clause, constitute a prohibited export subsidy, even though the borrower – and hence the exporter – was no better off than it would have been but for the payment.⁴⁶ The material advantage clause narrows the scope of the "*per se*" violation in the first paragraph of item (k) and precludes this result.⁴⁷

6.45 In light of the foregoing, we consider that the "material advantage" clause would not be rendered "ineffective" by a finding that the first paragraph of item (k) cannot serve as a basis to establish that a measure is "permitted".

(v) *Developing countries and the object and purpose of the SCM Agreement*

6.46 Finally, we recall Brazil's view that the first paragraph of item (k) must be read to "permit" payments that are not used to secure a material advantage – and that for this reason footnote 5 must be read broadly to apply to the first paragraph of item (k) – in order to ensure that developing country Members are not placed at a "permanent, structural disadvantage" in the field of export credit terms. Because this argument appears to us to be at the core of Brazil's defence, we consider that we must address it in some detail.

⁴⁴ Except to the extent it successfully invoked the second paragraph of item (k).

⁴⁵ We are assuming that the material advantage clause applies with respect to both forms of government activity referred to in the first paragraph of item (k), *i.e.*, direct export credit financing and payments. If it does not, then the ability of a developing country not exempted from the export subsidy prohibition to provide direct export credit financing could in practice be limited to situations where it could invoke the second paragraph of item (k).

⁴⁶ In such a case, there would be a benefit and thus a subsidy, but it would be a subsidy to a service provider, the financial institution.

⁴⁷ In fact, Brazil made a similar argument regarding the need for PROEX payments due to "Brazil risk" in the original dispute in this case. In the case of PROEX payments, however, the aircraft purchaser is free to seek the best export credit terms available in the market, whether from a Brazilian or foreign bank, and then receive a reduction in that interest rate in the amount of the payments. Thus, PROEX payments by definition allow a purchaser/borrower to obtain export credits at interest rates lower than it could obtain in the market with respect to the transaction in question.

6.47 We agree with Brazil that the *SCM Agreement* should not be interpreted in a manner that provides special and *less* favourable treatment for developing country Members in the field of export credit terms if the text of the Agreement permits of an alternative interpretation. In particular, an interpretation of the *SCM Agreement* that allowed developed country Members to consistently offer export credit terms more favourable than those that could in practice be offered by developing country Members – at least as of the date the export subsidy prohibition applies to any given developing country Member⁴⁸ – would be at odds with one of the objects and purposes of the *WTO Agreement* generally and the *SCM Agreement* specifically.⁴⁹

6.48 We consider however that the broad reading of footnote 5 urged by Brazil is not necessary in order to ensure equitable treatment for developing country Members. To the contrary, we fear that a broad interpretation of footnote 5 would have the opposite effect, and we consider that the natural reading of the footnote discussed above is more in keeping with this important object and purpose of the *WTO Agreement*.

6.49 The essence of Brazil's argument in this Article 21.5 dispute, and in the original dispute which gave rise to the recommendation the implementation of which we are considering here, is that items (j) and (k) of the Illustrative List permit developed country Members to provide, consistent with the *WTO Agreement* and the *Arrangement*, export credit terms that a developing country would not be able to meet. Brazil further considers that the only way in practice to rectify this imbalance is to interpret the first paragraph of item (k) to permit Members to provide payments in so far as they are *not* used to secure a material advantage and to interpret that clause in a sufficiently broad manner so as to allow developing countries to meet developed country export credit terms.⁵⁰

6.50 In the original dispute, Brazil's developing country argument focused on the second paragraph of item (k). We will therefore first address the implications of that paragraph for developing countries.

6.51 The second paragraph of item (k) creates a safe harbour for export credit practices that are in conformity with the interest rate provisions of the *Arrangement*.⁵¹ The *Arrangement* is a plurilateral

⁴⁸ In this respect, we recall that the prohibition on export subsidies does not apply to least-developed country Members, nor to Members listed in Annex VII until their GNP *per capita* reaches US\$1,000 per annum. Further, the prohibition does not apply to other developing country Members pursuant to Article 27 during an eight-year transition period (*i.e.*, until 1 January 2003) unless and until another Member demonstrates that a developing country Member has not complied with at least one of the elements set forth in Article 27.4. It will be recalled that Brazil is subject to the prohibition because it failed to abide by certain of these elements (Para 6.20, *supra*).

⁴⁹ The preamble to the *WTO Agreement* recognises

"that there is need for positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development."

This overarching concern of the *WTO Agreement* finds ample reflection in the *SCM Agreement*. Article 27 of that Agreement recognizes that "subsidies may play an important role in economic development programmes of developing country Members" and provides substantial special and differential treatment for developing countries, including in respect of export subsidies.

⁵⁰ Due to the nature of Brazil's defence in this case, we are required either to address the meaning of a number of provisions not directly invoked by Brazil, or to leave Brazil's fundamental object and purpose argument unanswered. Accordingly, and because, in our view, it is difficult to interpret the provisions invoked by Brazil without examining the broader context of other provisions of the *SCM Agreement* relating to export credit practices, we have chosen the latter course.

⁵¹ The text of the second paragraph of item (k) in fact refers 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)". We note that several "Sector

"gentlemen's" agreement, negotiated in the context of the Organization for Economic Cooperation and Development. The purpose of the *Arrangement*, as stated in its Introduction, is to "provide a framework for the orderly use of officially supported export credits" and to "encourage competition among exporters from the OECD-exporting countries based on quality and price of goods and services rather than on the most favourable officially supported terms". The *Arrangement* sets forth certain guidelines with respect to the terms and conditions of officially supported export credits with repayment terms of two years or more, including minimum interest rates for export credits benefiting from official financing support⁵² based on Commercial Interest Reference Rates, or CIRRs. There is a CIRR for the currency of each Participant to the *Arrangement*, which is constructed based upon long-term bond yields for that Participant plus a fixed margin (which for most currencies is 100 basis points, *i.e.*, one percentage point).

6.52 Brazil does not dispute that any Member, whether or not a Participant to the *Arrangement*, can invoke the second paragraph of item (k) in respect of its export credit practices which are in conformity with interest rate provisions of the *Arrangement*. Thus, in the case at hand, Brazil could provide dollar-denominated export credits in respect of Brazilian regional aircraft on terms that might otherwise be prohibited by Article 3.1(a) of the *SCM Agreement*, provided those export credits conformed to the interest rate provisions of the *Arrangement*.

6.53 Brazil argued, however, that developing countries could not afford to provide direct export credit financing at the CIRR rate, because of their high cost of funds, and thus could not in practice use the safe harbour created by the second paragraph of item (k). In order to avoid the high cost of direct financing, developing countries such as Brazil had to use a system of payments in support of export credits provided through commercial banks. Because commercial lenders in many cases have a lower cost of borrowing than the governments of developing countries, those governments could afford to "buy down" interest rates provided by commercial lenders at much lower cost than if they offered direct export credit financing itself.⁵³ Thus, developing countries needed to be able to use the first paragraph of item (k) as a safe harbour for payments that were equivalent in effect to the direct financing provided pursuant to the safe harbour in the second paragraph of item (k) by developed countries. This would only be possible if the first paragraph of item (k) could be used to establish that "payments" under the first paragraph of item (k) were "permitted" under certain circumstances.

6.54 Brazil's argument in the original dispute was not well-founded. Under the *Arrangement*, minimum interest rates in the form of CIRRs apply with respect to "official financing support", which includes "interest rate support". Thus, there is no reason why a developing country could not invoke the second paragraph of item (k) in respect of a payment scheme such as PROEX, provided that it is "in conformity with the interest rate provisions" of the *Arrangement*. In short, Brazil's argument that developing country Members needed to be able to use the first paragraph of item (k) as a safe harbour for their export credit interest buy-down schemes (and that footnote 5 thus had to be interpreted to

Understandings" (relating to ships, nuclear power plants, and civil aircraft) are annexed to the *Arrangement*, and that for some products – not including regional aircraft – a minimum interest rate different from the CIRR applies. We assume – but need not here decide – that an export credit practice in conformity with the interest rate provisions of these Sector Understandings would also be entitled to the safe harbour of the second paragraph of item (k).

⁵² As discussed *infra* at footnote 68, "official support" is a broader concept than "official financing support".

⁵³ To take a hypothetical and highly simplified example, imagine that the yield on the relevant US Government bonds (and thus the US Government's cost of borrowing) is 5 per cent, Brazil's cost of borrowing is 10 per cent and the interest rate on commercial export credits is 8 per cent. Because it is constructed based on the relevant US Government bond yields plus 1 percentage point, the US dollar CIRR would be 6 per cent. While developed countries could afford to borrow at 5 per cent and provide export credits at 6 per cent, Brazil could only do so by providing direct export financing at 4 percentage points below its own cost of borrowing, an expensive proposition. It would be much less costly for Brazil to allow a commercial lender to provide the export credits, and pay the lender 2 percentage points in the form of interest rate support.

apply in respect of the first paragraph of item (k)) because they could not in practice benefit from the safe harbour in the second paragraph was, in our view, simply incorrect.⁵⁴

6.55 In this implementation dispute, Brazil continues to argue that it must be allowed to use the first paragraph of item (k) to establish that an admitted export subsidy is "permitted" so that it can ensure the availability of WTO-consistent export credit financing for Brazilian products on terms equivalent to those that Canada is allowed to provide by the *SCM Agreement* and the *Arrangement*. Specifically, Brazil argues that Canada is allowed by the *Arrangement* and the *SCM Agreement* to provide or support below-CIRR export credits which, in the absence of the legal interpretations of the first paragraph of item (k) advanced by Brazil, cannot be met by Brazil as a practical matter without violating its WTO obligations.

6.56 In our view, however, the rules of the *SCM Agreement* as properly interpreted do not give rise to what Brazil refers to as a "permanent, structural disadvantage" in the field of export credit terms. We consider, however, that an unduly broad interpretation of footnote 5 to mean that measures not prohibited by an item of the Illustrative List are *permitted* would place developing country Members at a systematic disadvantage in respect of export credits.⁵⁵

6.57 To understand why this is so, we will first consider the implications in respect of direct export credit financing if the Panel were to find that footnote 5 should be interpreted to provide that measures not prohibited by the first paragraph of item (k) were "permitted". Under the first paragraph of item (k),

"[t]he grant by governments . . . of export credits at rates below those which they actually have to pay for the funds so employed . . . in so far as they are used to secure a material advantage in the field of export credit terms"

is an export subsidy prohibited by the *SCM Agreement*. The two conditions for the grant of export credits to fall within the scope of this paragraph – that (a) they are at rates below the government's cost of funds, and (b) they are used to secure a "material advantage" – are cumulative, *i.e.* they must both be satisfied in order for an export credit to fall within the scope of the paragraph. Thus, if we were to find that this paragraph could be used not only to establish that a measure is prohibited, but also to establish that certain measures are "permitted", it would follow that a WTO Member benefited from a safe harbour and provided a "permitted" export subsidy whenever it provided an export credit at above its own cost of funds (whether or not that export credit was used to secure a material advantage in the field of export credit terms).

6.58 As Brazil itself has so forcefully argued before the Panel, developing countries' costs of borrowing are almost inevitably higher than those of developed countries⁵⁶. Accordingly, if we adopted the interpretation advocated by Brazil, the first paragraph of item (k) would "permit" developed countries to provide export credits at an interest rate – the developed countries' own cost of funds – which developing countries would almost never be able to meet without falling afoul of the *SCM Agreement*. Thus, not only is a broad interpretation of footnote 5 not necessary in order to prevent placing developing countries at a "permanent, structural disadvantage" in the field of export

⁵⁴ We found in our original Report that "a developing country Member could under the second paragraph of item (k) provide interest rate support to reduce the interest rates on export credits to the levels allowed by the OECD Arrangement if it considered that direct financing at those rates was too expensive." There is no indication in the Appellate Body Report that Brazil challenged this conclusion on appeal, nor did the Appellate Body find to the contrary.

⁵⁵ Of course, the *SCM Agreement* cannot *remove* competitive disadvantages arising from structural differences between WTO Members; it should not however be interpreted in such a manner that the rules *themselves* place developing country Members at a disadvantage *vis-à-vis* developed country Members.

⁵⁶ According to Brazil – and Canada has not challenged Brazil's assertion – Brazil's cost of borrowing as of 1 February 2000, based on 10-year bond yields – was more than twice that of Canada.

credit terms but, to the contrary, such a broad interpretation of footnote 5 would in fact place developing countries at precisely the type of disadvantage in the field of export credit terms feared by Brazil.

6.59 The same situation exists in respect of item (j) of the Illustrative List. Brazil argues that its interpretation of the first paragraph of item (k) is necessary to allow it to meet export credit terms provided by developed country Members through export credit guarantees.⁵⁷ If footnote 5 is interpreted broadly to encompass the first paragraph of item (k), however, it presumably would also apply to item (j) and thus "permit" export credit guarantees at premium rates adequate to cover long-term operating costs and losses, even where the guarantees constituted a subsidy contingent upon export performance within the meaning of Article 3.1(a).⁵⁸ As Canada points out, however, in the case of a government guarantee, a lending bank establishes financing terms in light of the risk of the guarantor government, not the borrower.⁵⁹ Developed countries generally present a lower risk of default than developing countries, and a developing country may often be perceived as posing a higher risk than even the borrower to whom a guarantee might be extended. As a result, while developing countries in theory could utilise any "safe harbour" under item (j) to provide loan guarantees at the same premium rates as developed countries, the effect of guarantees by developing country Members on the interest rate of the guaranteed export credits would be minimal or non-existent in most cases. In other words, a broad reading of footnote 5 would, in respect of item (j), allow developed countries to support export credits at interest rates that would be consistently lower than those of export credits supported by developing countries.

6.60 If, on the other hand, we interpret footnote 5 in accordance with its ordinary meaning, and conclude that it does not apply to items such as the first paragraph of item (k) and item (j), then all WTO Members are faced with a common set of rules in respect of export credit practices.⁶⁰ First, they can ensure that those practices do not confer a benefit within the meaning of Article 1 and are therefore not subsidies.⁶¹ Because the existence of benefit is determined based on the existence of a benefit to a recipient, and without regard to whether there is a cost to the government,⁶² all Members compete on a level playing field in respect of this assessment, *i.e.*, a measure which constitutes an export subsidy when provided by Brazil *ipso facto* will also constitute a subsidy when provided by Canada, and vice versa.

6.61 *Second*, they can establish that a measure that is a subsidy contingent on export performance is nevertheless permitted because it benefits from the safe harbour provided by the second paragraph of item (k) for export credit practices that are in conformity with the interest rate provisions of the

⁵⁷ As Brazil explained in its first submission (para. 11), when presenting evidence of an export credit transaction supported by loan guarantees, "export credit guarantee programs are permitted by item (j) of Annex I to the *SCM Agreement*, provided they are at premium rates that are adequate to cover the long-term operating costs and losses of the program".

⁵⁸ Brazil in fact so argues. See Oral Statement of Brazil at the Meeting of the Panel, para. 34 ("There is nothing in the text of either item (j) or (k) to support the conclusion that an *a contrario* argument is permitted in one but not the other"). Canada does not disagree; rather, it takes the view that item (j), like item (k) first paragraph, cannot be used *a contrario* to establish that export credit guarantees at premium rates that are adequate to cover long-term operating costs and losses are "permitted". Canada points out that, if this were the case, then item (j), which operates on a cost-to-government basis, would be manifestly at odds with Article 14, which sets out a market-based benchmark for determining whether there is a benefit from a loan guarantee. In the Second Submission of Canada, para. 23.

⁵⁹ In the Second Submission of Canada, paragraph 36.

⁶⁰ Except, of course, to the extent that the *SCM Agreement* provides special and differential treatment for particular Members, as provided for in Articles 27 and 29 of that Agreement.

⁶¹ Assuming that their export credit practices are not *per se* violations under item (j) or item (k) first paragraph of the Illustrative List.

⁶² *Canada – Measures Affecting the Export of Civilian Aircraft ("Canada – Aircraft")*, Report of the Appellate Body adopted on 20 August 1999, WT/DSB70/AB/R, para. 156.

Arrangement. As noted earlier in this Report (para. 6.52, *supra*), the export credit practice of a Member which is not a Participant to the *Arrangement* but which "in practice applies the interest rate provisions" of the *Arrangement* benefits from the safe harbour of the second paragraph of item (k) provided that the practice is "in conformity with those [*i.e.*, the interest-rate] provisions."

6.62 We have already seen that, even if a developing country Member cannot in practice afford to provide direct export credit financing at the CIRR rate, it can take advantage of the safe harbour in the second paragraph of item (k) by providing interest rate support in order to bring export credits provided by commercial lenders down to the CIRR rate.⁶³ The question remains whether the second paragraph of item (k) would otherwise permit developed country Members to provide or support export credits which developing countries could meet only through the *a contrario* invocation of the first paragraph of item (k) argued by Brazil.

6.63 In this respect, Brazil first refers to the issue of "market windows". According to Brazil, some Participants to the *Arrangement*, including Canada, take the view that export credits provided by their export credit agencies are not "official support" and thus not subject to the terms of the *Arrangement* if they are provided at rates equal to or above their cost of funds.⁶⁴ According to Brazil, "this means that developed countries that are able to borrow US dollars at a rate below the CIRR rate are able to lend at that below-CIRR rate in conformity with the *Arrangement* as presently interpreted".⁶⁵ In other words, Brazil seems to be arguing that developed countries are permitted by the *Arrangement*, and thus by the *WTO Agreement*, to provide such below-CIRR export credits. Because developing countries have a higher cost of funds than do developed countries, their minimum interest rate under the second paragraph would be CIRR, and they would be unable to meet developed countries' market window operations. Thus, Brazil argues, developing countries must be "permitted" by operation of the first paragraph of item (k) to make payments resulting in export credits on equivalent terms.

6.64 Canada responds that Brazil confuses Canada's position on market windows. In Canada's view, the term "market windows" refers to circumstances where an export credit agency offers direct financing on terms comparable to those the recipient may receive in the market. In such circumstances, the agency is operating similarly to a private commercial bank, rather than as an *official* export credit agency. Thus, Canada argues that, for example, the Canadian Export Development Corporation, when operating under its Corporate Account, does not in any event confer a benefit and accordingly does not provide a subsidy within the meaning of Article I of the *SCM Agreement*.⁶⁶

6.65 We understand that the "market windows" debate, which is an ongoing one among the Participants, relates to whether or not certain export credit practices are "official support" and thus *subject* to the *Arrangement*. An export credit practice is not however "*in conformity with*" the "interest rate provisions" of the *Arrangement* within the meaning of the second paragraph of item (k) of the *SCM Agreement* merely because it is not *subject to* the *Arrangement*. To the contrary, we consider that the "interest rate provisions" to which the second paragraph of item (k) refers are those provisions that establish minimum interest rates.⁶⁷ At present, the only generally applicable minimum

⁶³ Provided, as discussed below, they respect the other provisions of the *Arrangement* which affect interest rates.

⁶⁴ First Submission of Brazil, para. 19.

⁶⁵ First Submission of Brazil, para. 24.

⁶⁶ Second Submission of Canada, para. 48. The disagreement between Brazil and Canada regarding what export credit practices qualify as "market window" operations appears to reflect that Canada's position on this question has evolved in the relatively recent past.

⁶⁷ This does not mean, however, that a Member may demonstrate that its export credit practice is in conformity with the interest rate provisions of the *Arrangement* merely by demonstrating that it has respected the minimum interest rates, irrespective of the other terms and conditions of the export credit in question. In our view, it would not be possible to make a meaningful assessment as to whether a Member has respected

interest rate under the *Arrangement* is the CIRR. Thus, an export credit which is provided through "market windows" at an interest rate below CIRR cannot be said to be "in conformity with" the interest rate provisions of the *Arrangement* and thus cannot benefit from the safe harbour provided for in that paragraph.⁶⁸ Accordingly – and in light of our understanding of the ordinary meaning of footnote 5 – whether an export credit practice involving below-CIRR interest rates is or is not prohibited by the *SCM Agreement* will depend solely upon whether or not it falls within the scope of Article 3.1(a), and in particular whether it confers a benefit and therefore represents a subsidy within the meaning of Article 1.⁶⁹

6.66 In short, an interpretation of footnote 5 which accords with its ordinary meaning and does not allow the first paragraph of item (k) to be read in an *a contrario* manner to "permit" certain measures not only does not generate a "permanent, structural disadvantage" for developing country Members in the field of export credit terms but, to the contrary, prevents developed country Members from obtaining, through the *a contrario* invocation of the Illustrative List, a consistent advantage over developing countries in the field of export credit terms. Accordingly, we do not agree with Brazil that the object and purpose of the *SCM Agreement* requires us to read footnote 5 more broadly than its ordinary meaning would suggest.

(vi) *Conclusion*

6.67 For the foregoing reasons, we conclude that the first paragraph of item (k) cannot be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) is "permitted".⁷⁰

(b) Are payments under PROEX "payments" within the meaning of the first paragraph of item (k) which are "used to secure a material advantage in the field of export credit terms"?

6.68 As discussed above, we do not consider that the first paragraph of item (k) can be used to establish that a measure which is a subsidy contingent upon export performance within the meaning of Article 3.1(a) is nevertheless "permitted". Nevertheless, we consider that we should resolve the issue whether payments under the "new" PROEX are used to secure a material advantage in the field of

minimum interest rates without verifying as well that it has respected those provisions of the *Arrangement* which affect interest rates.

⁶⁸ Our reasoning would apply equally to any other situation where the *Arrangement's* minimum interest rates do not or may not apply. Thus, export credit guarantees, although "official support" subject to the *Arrangement*, are not "official financing support" and thus are not subject to minimum interest rates. While guaranteed export credits thus may be provided at below-CIRR interest rates without violating the *Arrangement*, they cannot be considered to be "in conformity with" the interest rate provisions of the *Arrangement*. Similarly, there is no consensus among Participants about the treatment of official financing support for export credits at floating interest rates. While Canada considers that such export credits need not comply with the CIRR – given that the CIRR logically is relevant only to export credits at fixed interest rates – floating rate export credits provided at an interest rate below CIRR cannot be considered to be "in conformity with" the interest rate provisions of the *Arrangement*. Finally, while the *Arrangement* authorizes Participants to "match" export credit terms and conditions offered by Participants or non-Participants that do not conform to the *Arrangement*, it cannot be said that an export credit benefiting from official financing support that derogates from the minimum interest rate provisions of the *Arrangement* is "in conformity with" the interest rate provisions of the *Arrangement*.

⁶⁹ We recall in this respect our view that the first paragraph of item (k) does not "permit" the grant of export credits that are at or above a government's cost of borrowing. See para. 6.43, *supra*.

⁷⁰ Of course, we do not preclude that, in appropriate circumstances, an item of the Illustrative List might represent context relevant to an interpretation of Article 1 (or vice versa), although in this regard substantial caution would certainly be appropriate given that, on its face, the Illustrative List focuses on whether a measure is a *prohibited export* subsidy, not on whether it is a *subsidy*. See generally *United States – Tax Treatment for "Foreign Sales Corporations"*, Report of the Appellate Body adopted on 20 March 2000, WT/DS108/AB/R, para. 92.

export credit terms because such findings should facilitate Brazil's task in implementing the DSB's recommendations.

(i) *Are payments under PROEX "payments" within the meaning of the first paragraph of item (k)?*

6.69 Brazil argues that PROEX payments constitute the payment by Brazil of all or part of the costs incurred by Embraer or financial institutions in obtaining credits within the meaning of the first paragraph of item (k). As explained in our original Panel Report,⁷¹ Brazil's argument appears to be two-fold. *First*, Brazil contends that financial institutions must borrow funds in order to finance their lending, that the export credits so funded are provided at below their cost of borrowing, and that PROEX payments are provided to compensate the lenders for this difference. The difference between the lender's cost of borrowing and the rate it charges on the export credits represents a "cost incurred by . . . financial institutions in obtaining credits". *Second*, Brazil asserts that, although Embraer does not itself extend export credits to its customers, it incurs certain costs in relation to the provision of export credits by financial institutions. Brazil's arguments are linked to the principle that both Embraer and Brazilian financial institutions have high costs of borrowing as a result of "Brazil risk", *i.e.*, the Government of Brazil has a high cost of borrowing and Brazilian entities cannot borrow on terms more favourable than those of their government.

6.70 Canada agrees with the basic thrust of Brazil's interpretation of the notion of payments. In Canada's view, a payment exists within the meaning of the first paragraph of item (k) where an exporter or financial institution obtains credits at an interest rate higher than the rate at which it would provide export credits to a buyer and incurs a cost as a result, and the government pays for all or part of this difference. In Canada's view, however, PROEX payments are not "payments" in this sense. In this regard, it emphasises that Embraer does not itself provide export financing to its purchasers. Further, Canada asserts that PROEX payments are in practice paid when non-Brazilian purchasers finance their purchases through non-Brazilian financial institutions. Thus, Brazil risk is not relevant. Accordingly, Canada considers that PROEX payments are not payments to cover the costs incurred by exporters or Brazilian financial institutions in raising funds used for financing purchases.

6.71 It will be recalled that item (k) refers to the payment by governments of "all or part of the costs incurred by exporters or financial institutions in obtaining credits". In interpreting this provision, we must of course start with its ordinary meaning. In this respect, we note first the use of the word "credits" in the plural. It seems clear in context that the word "credits" refers to "export credits" as used earlier in the paragraph. Second, the costs involved are those relating to *obtaining* export credits, and not costs relating to providing them.

6.72 Read in light of the foregoing considerations, we do not believe that PROEX payments can be said to constitute "the payment by [a government] of all or part of the costs incurred by exporters or financial institutions in obtaining export credits". Brazil's argument equates the cost for a financial institution of raising capital with the cost of "obtaining [export] credits". While the financial institutions involved in financing PROEX-supported transactions certainly *provide* export credits, they cannot be seen as *obtaining* such credits. Further, if the drafters had intended to refer to payments related to a financial institution's cost of borrowing, the first part of the first sentence of item (k) demonstrates that they knew how to do so. In short, we do not agree that payments to a lender that amount to interest rate support can reasonably be understood to be payments of all or part of the costs of obtaining export credits.

6.73 Even if we did agree that the provision of export credits at below a financial institution's cost of borrowing entailed a "cost incurred by . . . financial institutions in obtaining credits", we are unconvinced that PROEX payments necessarily serve to reimburse such below-cost-of-borrowing

⁷¹ Original Panel Report, footnote 198, p. 80.

export credits. In this respect, we note that Brazil's argument focused on the fact that Embraer and Brazilian financial institutions had a high cost of borrowing as a result of "Brazil risk". As Canada points out, however, Embraer does not itself provide export credit financing, and the financial institutions receiving PROEX payments are not necessarily Brazilian financial institutions. Rather, they are in many cases leading international financial institutions unhampered by "Brazil risk". Thus, there is no basis for us to conclude, nor even to hypothesise, that the financial institutions in question are providing export credits at below their cost of funds.

(ii) *Are PROEX payments "used to secure a material advantage in the field of export credit terms"?*

6.74 The third and final element of Brazil's material advantage defence is that PROEX payments are not "used to secure a material advantage in the field of export credit terms" within the meaning of the first paragraph of item (k).

6.75 Brazil considers that it has modified PROEX in respect of regional aircraft such that PROEX payments are no longer used to secure a material advantage in the field of export credit terms. Specifically, Brazil argues that Resolution 2667

"means, effectively . . . that no application for PROEX interest rate equalisation support for regional aircraft will be favorably considered unless it reflects a net interest rate to the borrower equal to or more than the 10-year United States Treasury Bond ('T-Bill') plus 0.2 percent per annum. While the use of the T-Bill as the benchmark is preferred, the authorities retain the authority to utilise LIBOR as an alternative reference point in appropriate market circumstances"⁷²

Brazil requests the Panel to find that, "by requiring the net interest rate for any transaction supported by PROEX to equal or exceed an appropriate market benchmark – with the preferred benchmark being the T-Bill plus 20 basis points – Brazil has withdrawn the prohibited aspects of the PROEX programme."⁷³

6.76 In order to determine whether Brazil is correct in its view that payments pursuant to the PROEX scheme no longer are used to secure a material advantage in the field of export credit terms, we must first seek to resolve certain differences of view among the parties regarding the meaning of the "material advantage" clause as interpreted by the Appellate Body, and in particular the role of the CIRR in determining whether payments are or are not used to secure a material advantage in the field of export credit terms.

6.77 In Brazil's view, the Appellate Body found that PROEX was flawed because it lacked a benchmark based on the marketplace. According to Brazil, the Appellate Body found that Members are permitted to obtain an "advantage" in the field of export credit terms provided that advantage is not "material". It also made clear that the appropriate benchmark for determining whether a material advantage is secured is the marketplace and not a specific transaction.⁷⁴ Put another way, Brazil argues that the "primary flaw" in PROEX identified by the Appellate Body was "the absence of a floor net interest rate based on a cognizable benchmark rate in the commercial marketplace."⁷⁵ In the view of Brazil, while the Appellate Body identified the CIRR as 'one example' of an appropriate

⁷² First Submission of Brazil, para. 6.

⁷³ Second Submission of Brazil, para. 40.

⁷⁴ First Submission of Brazil, para. 4.

⁷⁵ Second Submission of Brazil, para. 30.

benchmark, Brazil chose a point of reference other than CIRR for PROEX based on evidence that, in the case of aircraft, the marketplace in fact supports lower interest rates.⁷⁶

6.78 Canada sees no basis in the rulings of the Appellate Body for Brazil's claim to a benchmark below CIRR even if Brazil could demonstrate that interest rates in the marketplace were below CIRR at some given moment. In the view of Canada, the Appellate Body used the second paragraph of item (k), and therefore the *Arrangement*, as useful context for arriving at the appropriate benchmark to be used in the first paragraph of item (k). The Appellate Body found that the CIRR constituted the *minimum* commercial interest rate for the purposes of the *Arrangement*. It determined accordingly that a net interest rate below the relevant CIRR was a positive indication that material advantage was being secured. There was no suggestion at all by the Appellate Body that any other, lower benchmark could appropriately be used instead of CIRR for item (k).

6.79 From the above, it is evident that Canada and Brazil have fundamentally different views about the legal significance of the CIRR as a benchmark for determining whether or not a payment is used to secure a material advantage. Canada considers that a payment that results in a net interest rate below CIRR *ipso facto* secures a material advantage. Brazil considers that a lower benchmark for determining whether a payment is used to secure a material advantage would be appropriate if it could be established that the "marketplace" in fact supports lower rates.

6.80 As noted above, Resolution 2667 sets what Brazil characterises as a minimum net interest rate for export credits supported by PROEX payments based on US 10-year Treasury Bonds plus 0.2 per cent (20 "basis points"). Canada argues, and Brazil does not dispute, that such a minimum interest rate is below CIRR.⁷⁷ Accordingly, if Canada is correct in its view that a payment that results in a net interest rate below the CIRR is *ipso facto* used to secure a material advantage, then PROEX payments are used to secure a material advantage. On the other hand, if Brazil is correct that an interest rate below CIRR does not imply a material advantage if the marketplace supports such a lower interest rate, then we must examine the evidence submitted by the parties in respect of the interest rates in the marketplace for regional aircraft.

6.81 In considering this issue, we have carefully reviewed the Report of the Appellate Body in the original dispute. The Appellate Body had before it the conclusion of the Panel that a 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 available to the purchaser in the marketplace with respect to the transaction in question".⁷⁸ The Appellate Body rejected the Panel's interpretation for two reasons. First, the Appellate Body found that the Panel had omitted the term "material" from its test, thus reading that term out of item (k). Second, the Appellate Body found that the Panel had interpreted the material advantage clause as equivalent to the term "benefit" in Article 1.1(b) of the *SCM Agreement*, thereby rendering that clause meaningless.

6.82 The Appellate Body then explained how the "material advantage" clause should properly be interpreted. Because the resolution of this dispute depends upon achieving a proper understanding of this clause as interpreted by the Appellate Body, we will quote *in extenso* from the Appellate Body's findings:

⁷⁶ First Submission of Brazil, para. 9.

⁷⁷ Second Submission of Canada, footnote 33; Response of Brazil to Question 1 of the Panel ("Brazil agrees that a net interest rate of 20 basis points above the 10-year US T-Bill normally is below the CIRR"). The United States as third party indicated that a review of data for the period 1970-99 showed that at no point during the period did the long-term CIRR go below the monthly average 10-year Treasury Bond plus 20 basis points, and that on average the long-term CIRR was 73 basis points above that benchmark (Response of the United States to Question 1 of the Panel to Brazil).

⁷⁸ Appellate Body Report, para. 7.33.

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." [footnote omitted].

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 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.[footnote omitted]. 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 equalisation 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 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." 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 equalisation subsidies for regional aircraft are provided at an "across-the-board" rate of 3.8 per cent for *all* export sales transactions.[footnote omitted] 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.

6.83 The text of the Appellate Body decision reveals elements that support the view of Canada in respect of the role of the CIRR. The language used by the Appellate Body in several places suggests that the CIRR is the sole and immutable benchmark against which material advantage is to be assessed. In particular, the Appellate Body's statement, in paragraph 182 of its Report, that "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 a particular export sales transaction after deduction of the government payment (the "*net* interest rate") and the relevant CIRR", is on its face absolute and would not allow of another benchmark. Similarly, in paragraph 183 the Appellate Body Report states, somewhat categorically, that, "[i]n 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."

6.84 In our view, however, a careful reading of the Report leads to the conclusion that the CIRR was not intended as the exclusive and immutable benchmark applicable in all cases. In this regard, we note in particular certain more nuanced language in paragraph 182 of the Report. Thus, the Appellate Body states that whether a payment is used to secure a *material* advantage "*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. In the very next sentence, the Appellate Body states that 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". The choice of the words "positive indication" strongly suggests that, while an interest rate below CIRR might be strong evidence that a payment was used to secure a material advantage, there could be circumstances where an interest rate below CIRR nevertheless was *not* used to secure a material advantage in the field of export credit terms.⁷⁹

6.85 Although we believe that the Appellate Body did not intend that a payment that resulted in a net interest rate below CIRR would *ipso facto* be deemed to secure a material advantage, we are not sure under exactly what circumstances this would not be the case. There are a number of possible readings of the Appellate Body Report, each of which would suggest a different approach to determining under what circumstances a payment resulting in a net interest rate below CIRR might not be considered to have been used to secure a material advantage in the field of export credit terms.

6.86 One interpretation would be that the Appellate Body simply considered that a payment would not be used to secure a material advantage in the field of export credit terms if it resulted in an export credit on terms and conditions that would be protected by the safe harbour of the second paragraph as being in conformity with the interest rate provisions of the *Arrangement*. If this were the case, then our examination would focus on whether Brazil's below-CIRR benchmark could have been justified as being equivalent to the terms and conditions of export credits that other Members could provide or support, or perhaps were actually providing or supporting, pursuant to the safe harbour of the second paragraph. The Appellate Body's reference to matching in the sense of the *Arrangement*, although by no means amounting to a finding that Brazil would not be securing a material advantage in the field of export credit terms if it were merely matching another Member's export credit terms, might be seen as implying such an approach.⁸⁰

6.87 We do not believe, however, that the Appellate Body report should be understood in this manner. As we have seen, all WTO Members, whether or not Participants to the *Arrangement*, are entitled to take advantage of the safe harbour in the second paragraph of item (k) to the extent their export credit practices are in conformity with the interest rate provisions of the *Arrangement*. Further, we have seen that, contrary to Brazil's assertions, the export credit practices which may benefit from this safe harbour include interest rate support. Thus, even if a measure not prohibited by the first paragraph of item (k) were "permitted", there is no obvious reason why the test in the second paragraph of item (k), *i.e.*, conformity with the interest rate provisions of the *Arrangement*, should be simply duplicated in the first paragraph, as this would be re-creating in the first paragraph the very safe harbour already provided for by the second paragraph. In addition, the fact that the Appellate Body does not incorporate *Arrangement* requirements in respect of terms and conditions other than interest rates in its material advantage test, such as minimum premiums for sovereign and country credit risk⁸¹ and maximum repayment periods, strongly suggests that it did not intend to equate the concept of material advantage in the field of export credit terms with conformity with the interest rate provisions of the *Arrangement*.

6.88 Another possible interpretation is that suggested by Canada. Although Canada does not say so explicitly, its view seems to be that the Appellate Body did not overrule the Panel's finding that the concept of "material advantage" was comparable to the question whether there was a benefit to the

⁷⁹ Brazil also refers to the statement of the Appellate Body 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 are used to secure a material advantage (emphasis added). Given that the Appellate Body referred to "one example" of an undertaking, and not "one example" of a benchmark, we are unsure how much weight should be placed on this element.

⁸⁰ For the reasons explained in paras. 6.62-6.65, *supra*, of this Report, however, we do not believe that an interest rate below CIRR could in fact ever be deemed to be "in conformity with" the interest rate provisions of the *Arrangement*.

⁸¹ Which, in the case of direct credits/financing and refinancing, must be charged on top of the CIRR. See the *Arrangement*, Article 15.

recipient.⁸² Rather, the Appellate Body merely found that such an advantage had to be "material" and, if the net interest rate was below CIRR, this was irrefutable evidence that the advantage was in fact "material".⁸³ Under this reading of the Appellate Body Report, if we understand it correctly, a PROEX payment resulting in an export credit at an interest rate above CIRR would still be used to secure a "material" advantage if it resulted in an export credit on "materially" better terms than the terms that would otherwise have been available in the marketplace *to the borrower in question*.⁸⁴ Given Canada's references in this context to purely commercial transactions – *i.e.*, transactions not benefiting from official support – we assume that Canada defines the "marketplace" to mean the purely commercial marketplace. Consistent with this interpretation, and in support of its position that the advantage conferred by PROEX payments is "material", Canada submitted affidavits from airlines indicating that a reduction in interest rates of as little as 25 basis points could have a material impact on their choice of aircraft.

6.89 We cannot however interpret the Appellate Body Report in this manner. If the Appellate Body meant what Canada now suggests it meant, there would have been no need for it to have referred to the CIRR in order to establish that the advantage in question was "material". In this respect, we recall that, under PROEX, a borrower negotiates the best interest rate it can obtain in international financial markets, and then benefits from a buy-down of that interest rate of 2.5 percentage points (3.8 percentage points under PROEX as it existed at the time of the original Panel Report). There was information in the record indicating that this interest rate buy-down reduced the total cost of an aircraft to a borrower by several million dollars⁸⁵, and in any event there could be little doubt that a 3.8 percentage point reduction in the interest rate on a long-term export credit would secure a "material" advantage in the field of export credit terms, *if* the point of comparison were in fact the terms otherwise available to that borrower in the commercial marketplace. Thus, the Appellate Body could have noted the failure of the Panel to consistently state that an advantage had to be "material", but concluded on the basis of the record that the amount of the PROEX payments could not but be used to secure a material advantage. The fact that the Appellate Body did not indicate to us that they considered the Panel's basic approach to be incorrect.

6.90 Brazil, by contrast, argues that "the appropriate reference for determining whether a material advantage is secured is the 'marketplace' and not a specific transaction".⁸⁶ In referring to the "marketplace", Brazil apparently means that a payment does not secure a material advantage if the net interest rate on the export credits is no lower than that which is available to purchasers of competing regional aircraft. In light of the "evidence" cited by Brazil (*See* paras. 6.94 and 6.97, *infra*) regarding interest rates in respect of regional aircraft, we conclude that Brazil would not distinguish between commercial and non-commercial benchmarks in determining what interest rates prevailed in the "marketplace". Put simply, Brazil's position seems to be that its payments do not secure a material

⁸² *I.e.*, a payment is used to secure a material advantage where the payment has resulted in the availability of an export credit on terms that are materially more favourable than the terms that would otherwise have been available in the marketplace *to the purchaser with respect to the transaction in question*.

⁸³ Thus, Canada asserts that, "in the unlikely event that PROEX results in a net interest rate that is above CIRR, such a rate still secures a 'material advantage' By its design, PROEX secures a material advantage". Response of Canada to Question 7 of the Panel.

⁸⁴ *See* Oral Statement of Canada at the Meeting of the Panel, paras. 97-98 ("[I]f a net interest rate is below the relevant CIRR, the 'payment' in question must be considered to have secured a material advantage. If, however, a net interest rate is above the CIRR, a party that claims the benefit of an *a contrario* exception, if such an exception existed, would have the burden of establishing that it does not secure a material advantage as compared to the prevailing market rate This is because an interest rate buy-down of 2.5 percentage points may well not bring the net interest rate in a transaction below the relevant CIRR in cases *where the credit of the borrower is particularly bad*. But, it would be untenable to argue that such a massive subsidisation would not, at the same time, secure a material advantage."(emphasis added).

⁸⁵ A report by Ernst and Young estimated that the net present value of the equalisation payments would total \$2,454,162 per aircraft (Exhibit 23 to First Submission of Canada in the original dispute).

⁸⁶ First Submission of Brazil, para. 4.

advantage provided that the resulting net interest rate is no lower than the interest rates available in respect of export credits for competing regional aircraft, irrespective of whether those interest rates are the result of market forces or government intervention.

6.91 In our view, however, Brazil's approach is also inconsistent with the choice of CIRR as benchmark by the Appellate Body. The Appellate Body seems to have identified the CIRR as a relevant benchmark under the material advantage clause because it represents the "*minimum commercial interest rate*" faced by a potential borrower in respect of a particular currency. In this respect, we note that, under the *Arrangement*, the CIRR is established according to a number of principles, including that the CIRR should represent final commercial lending interest rates in the domestic market of the currency concerned, that it should closely correspond to the rate for first-class domestic borrowers and to a rate available to first-class foreign borrowers and that it should not distort domestic competitive conditions.⁸⁷ In other words, the CIRR is intended in principle to approximate the interest rate that first-class borrowers would pay "commercially", *i.e.*, in private transactions not benefiting from official support. The reasoning of the Appellate Body in choosing the CIRR seems to have been that a payment would be used to secure a *material* advantage, as opposed to an advantage that was not material, if it resulted in an interest rate that was below the lowest *commercial* interest rates available to the best borrowers in respect of a particular currency, irrespective of whether that rate would have been available to the borrower in question.

6.92 For the foregoing reasons, we consider that a Member may under the first paragraph of item (k) as interpreted by the Appellate Body establish that a payment was not used to secure a material advantage in the field of export credit terms, even if it resulted in a below-CIRR interest rate, if it could establish that the net interest rate resulting from the payment was not lower than the minimum *commercial* interest rate in respect of that currency.⁸⁸

6.93 That being the case, the next question we must address is whether Brazil has demonstrated that the benchmark it has chosen as the floor net interest rate for export credits supported by PROEX payments is in fact equal to or higher than the "minimum commercial interest rate" available in the marketplace. In considering this question, we recall that Brazil is seeking to use the first paragraph of item (k) as an affirmative defence and that it therefore bears the burden of establishing entitlement to it.⁸⁹ At the same time, and conscious that Canada might have access to relevant information not in the possession of Brazil, we have exercised our authority to seek certain information from Canada,⁹⁰ and we have taken the responses of Canada into account when examining this issue.

6.94 The first piece of evidence relied on by Brazil in support of the view that there are commercial interest rates below CIRR is documentation relating to the terms of an export financing transaction at a floating interest rate for large civil aircraft supported by export credit guarantees from the United States Export-Import Bank. Brazil compared the interest rate on this transaction (LIBOR plus 3 basis points) plus an amount to reflect a one-time guarantee fee it estimated to have been charged by the Export-Import Bank, to the "minimum" net interest rate for export credits benefiting

⁸⁷ *OECD Arrangement*, Article 15.

⁸⁸ We note that it would make little sense to compare the interest rate on a floating rate loan with the CIRR when determining whether an export credit or payment was "used to secure a material advantage in the field of export credit terms". We assume that in such circumstances the issue of material advantage would be assessed on the basis of the minimum commercial interest rate for comparable floating-interest rate export credits.

⁸⁹ Original Panel Report, para. 7.17. Of course, we have determined that the first paragraph of item (k) cannot be used to establish that a measure is "permitted" (para. 6.67, *supra*). If a complainant sought to use the first paragraph of item (k) to establish that a measure was *prohibited*, the complainant would, as in all cases, bear the initial burden of presenting evidence and argument sufficient to establish a *prima facie* case of violation. See *EC – Measures Concerning Meat And Meat Products (Hormones)*, Report of the Appellate Body adopted on 13 December 1998, WT/DS26/AB/R, WT/DS48/AB/R, para. 98.

⁹⁰ See Responses of Canada to Questions 4 and 5 of the Panel.

from PROEX payments (10-year US Treasury Bonds plus 20 basis points) and concluded that the "minimum" net interest rate for PROEX-supported export credits was higher than that of the Export-Import Bank-supported transaction. Brazil further argued that this transaction appeared to involve a Chinese purchaser, and that the guarantee fee in respect of airline borrowers from developed countries such as Switzerland would be lower. In Brazil's view, this example demonstrates that the marketplace supports interest rates below the "minimum" net interest rate for export credits supported by PROEX payments, and that PROEX payments therefore are not used to secure a material advantage in the field of export credit terms.

6.95 Canada challenges the relevance and comparability of the transaction referred to by Brazil. First, it argues that this transaction involves a loan guarantee, rather than direct financing. It considers that, because the first phrase of the first paragraph of item (k) refers to direct export credit financing, it would be incongruous if "the field of export credit terms" in the second clause of that paragraph included loan guarantees. In other words, Canada seems to be arguing that, in determining whether a payment is used to secure a material advantage in the field of export credit terms, export credits supported by government guarantees cannot be taken into account. We agree with Canada, but not for the reasons it has expressed in this dispute. It seems clear to us that the fact the export credit terms in question here are the result of a guarantee is of little relevance.⁹¹ On the other hand, the fact that these terms are the result of a *government* guarantee is highly relevant, if we are correct that, in order to justify a benchmark below CIRR, Brazil must demonstrate that the *commercial* marketplace supports interest rates as low as the rate for 10-year US Treasury Bonds plus 20 basis points. Clearly, Brazil has not demonstrated that the interest rate on this financing transaction, which is the direct result of a government guarantee, is a commercial or market rate of interest.

6.96 In any event, the financing transaction relied upon by Brazil is a floating-rate transaction, while the "minimum" net interest rate set by Brazil in respect of export credits supported by PROEX payments relates to transactions at fixed interest rates.⁹² In response to a question from the Panel as to how Brazil's benchmark rate would be applied in the case of floating interest rate transactions, Brazil explained that there are no records that PROEX transactions for aircraft have involved floating interest rates, nor are such transactions anticipated. Brazil further stated that it has not determined what "floor" rate it would apply if it provided PROEX payments in support of floating interest rate transactions, although it would have to be compatible with market rates.⁹³ Under these circumstances, it is hard to understand what relevance the terms of a floating interest rate transaction might have for the case at hand.

6.97 The second piece of "evidence" cited by Brazil involves a legal issue related to the application of the *Arrangement* known as "market windows". As noted earlier in this Report, the gist of the market windows argument is the view of Canada that an export credit agency, such as the Export Development Corporation, under certain circumstances is not providing "official support", and is therefore not subject to the *Arrangement*. It may therefore under certain circumstances provide export credits on terms more favourable than those envisioned by the *Arrangement* (e.g., at an interest rate below CIRR). Brazil relies on this fact as evidence that Canada may provide export credits for regional aircraft at rates which are below the CIRR, and argues that under these circumstances Brazil as well should be entitled to support through PROEX payments export credits at a net interest rate below CIRR.

⁹¹ For example, a parent company might guarantee an export credit of a subsidiary, thereby allowing the subsidiary to borrow at a lower interest rate.

⁹² Because a fixed interest rate locks in the lender for the duration of the export credit, lenders typically charge higher interest on a fixed interest rate loan than on a floating interest rate loan. Thus, it makes little sense to compare fixed interest rates to floating interest rates.

⁹³ Response of Brazil to question 8 of the Panel.

6.98 Based on our understanding of the Appellate Body's Report, the fact that Canada considers itself entitled to provide through its Export Development Corporation export credits on terms that are more favourable than those allowed by the *Arrangement* is not in itself a reason to conclude that Brazilian payments resulting in net interest rates comparable to those offered by Canada were not used to secure a material advantage in the field of export credit terms. After all, and for the reasons set forth in para. 6.65 of this Report, any export credits provided by the EDC in respect of regional aircraft at an interest rate below CIRR are not protected by the safe harbour of the second paragraph of item (k). Accordingly – and in light of our view that Members cannot use the first paragraph of item (k) to establish that a subsidy is "permitted" – Brazil would be free to challenge any such export credits to the extent that they were subsidies within the meaning of Article 1 that are contingent upon export performance within the meaning of Article 3.1(a), just as Canada could challenge any export credits on the same basis.

6.99 We were, however, struck by Canada's assertion that export credits provided by EDC through the "market window", even at interest rates below CIRR, were nevertheless "commercial" export credits that did not confer a benefit within the meaning of Article 1. Assuming this were the case, then, applying the Appellate Body's reasoning as we understand it, the existence of these "commercial" interest rates at below CIRR would mean that Brazil could itself provide PROEX payments resulting in below-CIRR net interest rates without securing a material advantage and therefore not fall within the scope of the *per se* prohibition.⁹⁴ Accordingly, and in light of the fact that information regarding the terms of EDC export credits was in the sole control of Canada, the Panel asked Canada to indicate whether any Canadian government agency, including EDC, had provided export credits in respect of regional aircraft at an interest rate below CIRR since 1 January 1998 and, if so, to indicate the interest rates at which such export credits were provided.

6.100 Canada responded that it has since 1 January 1998 provided export credits in respect of regional aircraft at interest rates below CIRR.⁹⁵ Although it does not identify the aircraft financed, the borrowers or the precise terms and conditions of these transactions, it does provide certain information in respect of them. In particular, we know that these transactions involved direct financing (as opposed to guarantees) and that they involved fixed interest rates.

6.101 Canada informs us that one of these transactions was a Canada Account transaction which involved "matching". Although Canada asserts that this transaction "was implemented in full compliance with the *Arrangement*", it does *not* assert that this transaction was in any sense a market-based transaction.

6.102 Canada further confirms that "there were instances where certain of EDC's financing transactions were at a rate less than the CIRR applicable on the date the transaction closed." Canada does not specify the number of such below-CIRR transactions, nor the share of EDC's regional aircraft transactions made at below-CIRR interest rates. It does however insist that these transactions were "market-based and commensurate with the risk associated with the particular borrower, and said transactions included customary collateral security protection". Canada explains in some detail that the situation of below-CIRR market rates can arise because the CIRR lags behind the market. Thus, in cases where interest rates are falling, the market rate at the time a transaction is closed can be lower than the CIRR, which is constructed on the basis of bond rates in an earlier period. For example, the

⁹⁴ Canada asserts that in *Canada - Aircraft* the Panel and Appellate Body found that, in providing direct financing under its Corporate Account, the EDC operates on the basis of commercial principles and does not provide an advantage above and beyond the market. In fact, the Appellate Body upheld a finding by the Panel that Brazil "had not established a *prima facie* case" that the debt financing activities of the EDC in support of the Canadian regional aircraft industry confer a 'benefit' within the meaning of Article 1.1(b) of the *SCM Agreement*. Appellate Body Report, para. 220. This falls far short of an affirmative finding that the financing in question did *not* confer a benefit.

⁹⁵ Response of Canada to Question 4 of the Panel.

CIRR applicable to transactions closing during the period 15 September – 15 October would be constructed using the average of the 7-year Treasury for the month of August, plus 100 basis points. Accordingly, Canada concludes, "[t]o an entity that operates on the basis of market principles, the calculation of the CIRR is such that it would not be considered a reliable reflection of current market conditions." Finally, Canada categorically asserts that, with the exception of the Canada Account transaction, the interest rate "in every case has been well above Brazil's preferred PROEX rate of 10-year Treasury plus 20 basis points."

6.103 We are not in a position to perform an independent assessment as to whether the below-CIRR export credits provided by Canada in respect of regional aircraft were or were not at commercial rates, as Canada has not provided us with any details concerning the specific terms and conditions of the transactions in question. Nevertheless, in light of Canada's clear admission not only that there can be commercial interest rates below CIRR but also that Canada itself has provided export credits in respect of regional aircraft at such below-CIRR "commercial" interest rates, we conclude that payments in respect of export credit financing for regional aircraft at below-CIRR interest rates are not necessarily used to secure a material advantage in the field of export credit terms as that term has been interpreted by the Appellate Body.

6.104 That said, the ultimate question in this dispute is not whether *any* below-CIRR commercial interest rates in respect of regional aircraft financing may be said to involve a material advantage, but whether Brazil has demonstrated that PROEX payments aimed at achieving the benchmark rate set by Brazil – a net interest rate on fixed interest rate export credits based on the 10-year US Treasury Bond plus 20 basis points – are not used to secure a material advantage in the field of export credit terms. We recall that the benchmark established by Brazil in respect of export credits supported by PROEX payments is below the relevant CIRR, and we note in addition that Brazil has presented *no* evidence that export credits at fixed interest rates in respect of regional aircraft⁹⁶ are being provided in the *commercial* market to any borrower at the benchmark rate of 10 year US Treasury bonds plus 20 basis points established by Brazil. We recall that, because Brazil is seeking to assert an "affirmative" defence, and that it bears the burden of demonstrating entitlement to that defence. We further note that, in respect of access to information regarding commercial interest rates – and with the exception of information regarding export credits provided by EDC at rates alleged by Canada to be "commercial" – such information is equally accessible to Brazil and Canada.

6.105 In respect of that information which is in the exclusive possession of Canada, Canada has categorically stated that, with the exception of one Canada Account transaction which clearly is *not* commercial, all fixed interest rate export credit financing provided by Canadian government agencies, including EDC export credits at rates below CIRR, has been at rates "well above" the Brazilian benchmark. We cannot assume bad faith on the part of Canada and therefore must accept the veracity of these statements.⁹⁷

6.106 For the foregoing reasons, we find that Brazil has failed to demonstrate that PROEX payments are not "used to secure a material advantage in the field of export credit terms" within the meaning of the first paragraph of item (k).

(c) Conclusions and closing remarks

In this section of our Panel Report, we have found that:

⁹⁶ Or, for that matter, any aircraft. As noted in paras. 6.92 – 6.95 of this Report, the only evidence presented by Brazil relevant to the interest rates in respect of export credits for aircraft involved non-commercial, floating interest rates.

⁹⁷ Cf., *Chile - Taxes on Alcoholic Beverages*, Report of the Appellate Body adopted on 12 January 2000, WT/DS87/AB/R-WT/DS110/AB/R, para. 74.

- (i) PROEX payments in respect of regional aircraft pursuant to the PROEX scheme as modified are subsidies contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement*;
- (ii) Brazil has failed to demonstrate, both as a matter of law and as a matter of fact, that PROEX subsidies are "permitted" by the first paragraph of item (k). In this respect, we recall our finding that the first paragraph of item (k) cannot be used to demonstrate that a subsidy contingent upon export performance within the meaning of Article 3.1(a) is "permitted". We further recall our findings that Brazil has failed to establish (a) that PROEX payments are "payments" within the meaning of the first paragraph of item (k); and (b) that PROEX payments are not "used to secure a material advantage in the field of export credit terms".

Therefore, we conclude that PROEX payments in respect of regional aircraft under the PROEX scheme as modified by Brazil are export subsidies prohibited by Article 3 of the *SCM Agreement*. Accordingly, we conclude that in this respect Brazil has failed to implement the recommendation of the DSB that it withdraw the export subsidies for regional aircraft under PROEX within 90 days.

6.107 We note that Brazil's effort to defend PROEX payments as "permitted" under the first paragraph of item (k) of the Illustrative List centred on the notion that a developing country Member had to be "permitted" by that paragraph to provide otherwise prohibited export subsidies in order to meet WTO-consistent competition from developed country Members in the field of export credit terms. In our view, however, the *SCM Agreement* as properly interpreted establishes a level playing field for all Members in respect of export credit practices (except, of course, to the extent that a Member is exempted from the export subsidy prohibition by reason of special and differential treatment). Under these circumstances, if a developing country Member (or indeed any Member) encounters an export credit that has been provided on terms that it cannot meet consistent with the *SCM Agreement*, the proper response is to challenge that export credit in WTO dispute settlement.⁹⁸

VII. CONCLUSION

7.1 For the reasons set forth in this Report, we conclude that Brazil's measures to comply with the Panel's recommendation either do not exist or are not consistent with the *SCM Agreement*. Accordingly, we conclude that Brazil has failed to implement the DSB's 20 August 1999 recommendation that it withdraw the export subsidies for regional aircraft under PROEX within 90 days.

7.2 Canada requests that we suggest, pursuant to Article 19.1 of the *DSU*, that the parties develop mechanisms that would allow Canada to verify compliance with the original recommendation of the DSB. Canada notes that Brazil has a reciprocal interest in verifying Canada's compliance in a parallel dispute, *Canada – Aircraft*.⁹⁹ Canada emphasises that it is *not* seeking a continuing role for the Panel in proposing such verification procedures, nor is it requesting that we impose such procedures. Brazil responds that, although it does not in principle oppose an agreement with Canada on reciprocal transparency, it does not consider that it is an appropriate matter for a suggestion under Article 19.1 of the *DSU*, but is better left to be agreed by the parties. Brazil notes that any such agreement would have to involve balanced and truly reciprocal offers of transparency.

⁹⁸ In this regard, we recall the statement of the Appellate Body in *Canada – Aircraft* that: "we do not intend to suggest that Brazil is precluded from pursuing another dispute settlement complaint against Canada, under the provisions of the *SCM Agreement* and the *DSU*, concerning the consistency of certain of the EDC's financing measures with the provisions of the *SCM Agreement*."

⁹⁹ First Submission of Canada, para. 45.

7.3 We note that Article 19.1 provides that "the panel . . . may suggest ways in which the Member concerned could implement the recommendation". In our view, Article 19.1 appears to envision suggestions regarding what could be done to a measure to bring it into conformity or, in case of a recommendation under Article 4.7 of the *SCM Agreement*, what could be done to "withdraw" the prohibited subsidy. It is not clear if Article 19.1 also addresses issues of surveillance of those steps. That said, any agreement that WTO Members might reach among themselves to improve transparency regarding the implementation of WTO obligations can only be encouraged.