WORLD TRADE ORGANIZATION

WT/DS46/R
14 April 1999

(99-1402)

Original: English

BRAZIL – EXPORT FINANCING PROGRAMME FOR AIRCRAFT

REPORT OF THE PANEL

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I. INTRODUCTION

1.1 On 18 June 1996, Canada requested consultations with Brazil under Article 4 of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement") and Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), regarding "certain export subsidies granted under the Brazilian Programa de Financiamento as Exportações ("PROEX") to foreign purchasers of Brazil's EMBRAER aircraft."[1]

1.2 Canada and Brazil held consultations on 22 and 25 July 1996 in Geneva, but failed to reach a mutually satisfactory solution. On 16 September 1996, Canada requested the establishment of a panel under Articles 4 and 30 of the SCM Agreement and Articles 4 and 6 of the DSU.[2] In a communication dated 23 September 1996 and addressed to the Dispute Settlement Body ("DSB"), Brazil reserved its rights to invoke Article 27 of the SCM Agreement before any panel that was established to examine the matter at issue, and requested that the terms of reference proposed by Canada explicitly recognize Brazil's right to do so.

1.3 On 3 October 1996, Canada again requested the establishment of a panel.[3] That request was subsequently withdrawn to allow the parties to seek a mutually satisfactory solution to the problem.

1.4 On 10 July 1998, Canada again requested the establishment of a panel under Article 4 of the SCM Agreement.

1.5 At its meeting on 23 July 1998, the Dispute Settlement Body ("DSB") established a Panel in accordance with Article 4 of the SCM Agreement with the following standard terms of reference:

> "To examine, in the light of the relevant provisions of the SCM Agreement, the matter referred to the DSB by Canada in document WT/DS46/5 and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in that agreement."[4]

1.6 The European Communities ("EC") and the United States ("US") reserved their rights to participate in the panel proceedings as third parties.[5]

1.7 On 16 October 1998, Canada requested the Director-General of the WTO to determine the composition of the Panel, pursuant to Article 8.7 of the DSU. On 22 October 1998, the Director-General composed the Panel as follows:

Chairman: Mr. Dariusz Rosati

Members: Professor Akio Shimizu
Mr. Kajit Sukhum

1.8 The Panel met with the parties on 23/24 November 1998 and 14 December 1998. It met with the third parties on 24 November 1998.

1.9 The Panel submitted its interim report to the parties on 17 February 1999. On 25 February 1999 both parties submitted written requests for the Panel to review precise aspects of the interim report, and

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[1] *See* Canada's request for consultations, WT/DS46/1.
[2] WT/DS46/5; 13 July 1998.
[3] WT/DS46/4; 4 October 1996.
[4] WT/DS46/7; 28 October 1998.
[5] WT/DS46/6; 19 August 1998.

on 3 March 1999 each party submitted written comments regarding the other's request. Neither party requested a further meeting with the Panel. The Panel submitted its final report to the parties on 12 March 1999.

1.10 Given the nature of the dispute, and with the agreement of the parties, special procedures were created by the Panel for handling business confidential information. The special procedures are found in Annex 1 to this report. Under paragraph VII:2 of these procedures, "[t]he Panel shall not disclose Business Confidential Information in its interim and final reports, but may make statements of conclusion drawn from such information." Thus, where Business Confidential Information had been submitted by a party in support of a claim, it is mentioned in the report, but details of such information are not disclosed.

II. FACTUAL ASPECTS

2.1 This dispute concerns payments under the interest rate equalization component of the Programa de Financiamento as Exportações ("PROEX"), the export financing support programme of Brazil, on exports of Brazilian regional aircraft. 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.[6] PROEX provides export credits to Brazilian exporters either through direct financing or interest rate equalization payments.[7]

2.2 With direct financing, Brazil lends a portion of the funds required for the transaction. With interest equalization, underlying legal instruments provide that the "National Treasury grant[s] to the financing party an equalization 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."[8]

2.3 The financing terms for which interest rate equalization 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 been extended to 15 years. The length of the financing term, in turn, determines the spread to be equalised: the payment ranges from 2 percentage points per annum, up to 3.8 percentage points per annum for a term of nine years or more.[9] The spread is fixed and does not vary depending on the lender's actual cost of funds.[10]

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 jet aircraft, the most frequent waiver has been to extend the length of the financing term from ten to fifteen years.

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[6]As of the date of the request for the establishment of a panel, the relevant legal instrument was Provisional Measure 1700/15 of 30 June 1998. It replaced Provisional Measure 1629-13 of 12 February 1998, which had replaced the basic law establishing PROEX, Law No. 8.187 of 1 June 1991, as amended by Resolution 2380 of 25 April 1997.

[7]Law No. 8.187, 1 June1991 (Exhibit Bra-3), replaced by Provisional Measure No. 1629, 12 February 1998 (Exhibit Bra-4).

[8]*See*, for example, Resolution 2380/97 of 25 April 1997.

[9]*See* Central Bank of Brazil Circular Letter number 2.601 dated 29 November 1995. Prior to that date, the spread to be equalised for financing for a term of nine years or more was 3.5 percentage points.

[10]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 approval 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 PROEX 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. If a contract is not entered into within the specified time, the commitment contained in the letter of approval expires.

2.6 PROEX interest equalization 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. These are denominated in Brazilian Reais indexed to the United States dollar. 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 months 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

A. FINDINGS OF FACT

3.1 **Canada** requests the Panel to make the following findings of fact:

(a) That PROEX interest equalization payments are made in the form of instalments or lump sums.

(b) That PROEX interest equalization payments have been made in respect of the following transactions: (a) Brasilia 120 model (Skywest, Great Lakes Airlines; Rio Sul and other unspecified transactions); (b) ERJ-145 model (American Eagle; British Regional; Portugalia; Regional; Rio Sul; Siv Am; Wexford; Continental Express ("COEX"); Trans States; Luxair; City Airlines; and other unspecified transactions).

(c) That the level of PROEX and BEFIEX expenditures has increased since 1 January 1995 and, as a result, the level of Brazilian export subsidies has increased since that date.

(d) That PROEX and BEFIEX, and therefore Brazilian export subsidies, are not being phased out by 31 December 2002.

B. FINDINGS OF LAW

3.2 **Canada** requests the Panel to make the following findings of law:

(a) That, as admitted by Brazil, PROEX interest equalization payments are export subsidies within the meaning of Article 3 of the SCM Agreement.

(b) That, more specifically, but without foregoing the generality of the previous finding, PROEX interest equalization payments made in respect of the following transactions are prohibited export subsidies: (a) Brasilia 120 model (Skywest, Great Lakes Airlines; Rio Sul and other unspecified transactions); (b) ERJ-145 model (American Eagle; British Regional; Portugalia; Regional; Rio Sul; Siv Am; Wexford; Continental Express ("COEX"); Trans States; Luxair; City Airlines; and other unspecified transactions).

(c) That the first paragraph of Item (k) of Annex 1 of the SCM Agreement does not provide an exception to Article 3.

(d) That, even if the first paragraph of Item (k) does provide, through an a contrario inference such an exception, PROEX interest equalization payments are not payments within the meaning of Item (k), or do provide a material advantage in the field of export credit terms, and as such do not fall within the exception.

(e) That Brazil does not meet the conditions set out in Article 27.4 and that, as a result, it does not benefit from the eight year grace period from the general prohibition on export subsidies in Article 3, provided for developing countries under Article 27.2(b).

C. RECOMMENDATIONS

3.3 In its first written submission to the Panel, **Canada** requested the Panel to make the following recommendations:

(a) "Brazil shall not grant new subsidies under PROEX, including subsidies promised or committed, but not yet granted, on regional aircraft not yet delivered";

(b) "Brazil shall no longer maintain existing subsidies under PROEX and must terminate such subsidies no later than three months after the adoption of the Report of the Panel by the DSB"; and

(c) "Brazil shall withdraw without delay PROEX subsidies granted pursuant to transactions entered into following the composition of the Panel on October 22, 1998."

In its second oral submission to the Panel, **Canada** further requested the Panel to make the following recommendations:

(d) That, if the Panel finds that PROEX interest equalization export subsidies are granted on an instalment basis at the time of the periodic payment of the subsidies, the Panel recommend that such payments be terminated no later than 3 months after the date of the adoption of the Panel's Report by the Dispute Settlement Body, in respect of aircraft that have already been delivered or in respect of any aircraft delivered after that date.

(e) That, if the Panel finds that PROEX subsidies are granted at the time of the delivery of the aircraft, the Panel recommend that no such subsidies be granted in respect of any aircraft delivered after the date of the adoption of the Panel's Report by the DSB.

(f) That the Panel recommend that any PROEX interest equalization export subsidies paid or granted in respect of any new orders of aircraft between the date of the composition of the Panel on October 22, 1998 and the date that the Panel Report is adopted by the DSB

be withdrawn as prohibited export subsidies intended to circumvent the Panel's recommendations.

3.4 **Brazil** requests the Panel to find that "PROEX is not inconsistent with Brazil's obligations under Article 3 of the Agreement on Subsidies and Countervailing Measures."

IV. MAIN ARGUMENTS OF THE PARTIES

A. PRELIMINARY OBJECTION

4.1 **Brazil** raises a preliminary objection to the Panel's consideration of certain measures listed in Canada's request for the establishment of a Panel on the ground that the parties never consulted about these measures. The measures with regard to which Brazil raises this objection are Provisional Measures 1700/15 and 1629/13; Decree No. 2414 of 12/9/97; Resolutions of the National Monetary Council Nos. 2490/98, 2452/97, 2381/97 and 2380/97; and MICT Orders 28/98, 23/98, 7/98, 121/97, 83/97, 53/97, 34/97 and 33/97.

4.2 Brazil submits that the parties consulted in Geneva on 22 and 25 July 1996 and on 4 November 1996, and in Brasilia on 21-22 November 1996. However, since each of the identified measures was either enacted or implemented after consultations were held, they could not have been the subject of consultations. Brazil further argues that although the parties met in Rio de Janeiro on 8-9 June 1998 and in Washington D.C. on 25-26 June 1998, they did not consult on the identified measures. In any case, Provisional Measure 1700/15 was enacted on 30 June 1998 and, as such, post-dated even the Washington meeting.

4.3 Brazil argues that it is the absolute right of every Member to consult about a challenged measure before being required to defend it before a Panel. Measures which were not consulted upon by the parties could not properly be within the terms of reference of the Panel and as such should not be examined by the Panel. If Members were to have the right to ask for the establishment of a panel without having consulted about the measures, it would undermine the importance of consultations in the WTO dispute settlement mechanism and undermine the practical significance of Article 4 of the DSU.

4.4 In response to a question from the panel,[11] Brazil stated that its preliminary objection is grounded in both the provisions of the DSU and the SCM Agreement. Brazil submitted that in *Japan – Measures Affecting Agricultural Products*[12], the parties disagreed as to whether consultations occurred regarding the measure at issue. Japan argued that they had not consulted, while the United States asserted that the parties in fact had consulted with regard to the measure.[13]

4.5 Brazil argues that this dispute is very different. Brazil submits that in this dispute both Brazil and Canada agree that consultations did not encompass the measures in issue. The assertion to the contrary in the request for the establishment of a panel was an obvious and admitted error. Consequently, unlike *Japan – Agricultural Products*, there is no question that consultations regarding these measures did not take place.[14]

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[11] Brazil's Response to Questions From the Panel, No. 3.

[12] *Japan – Measures Affecting Agricultural Products*, WT/DS76/R, para. 8.4., circulated to Members on 27 October 1998. Japan notified its intention to appeal on 24 November 1998.

[13] *Ibid.*

[14] *Ibid.*

4.6 Brazil asserts that in *Japan – Agricultural Products*, as well as in E*uropean Communities - Bananas*[15], which is cited in that decision, the Panel was faced with an inability to resolve a factual disagreement between the parties. Brazil submits that those Panels had no way of determining what, in fact, had taken place at consultations. In these circumstances, both Panels reasonably relied upon the text of the request for the establishment of a panel which was incorporated in the terms of reference.[16] This Panel is not faced with the need to resolve a factual dispute between the Parties concerning the subject matter of consultations. It is faced, however, with the responsibility, stated by the Appellate Body in *Bananas*, "to examine the request for the establishment of the panel very carefully to ensure its compliance with both the letter and the spirit of Article 6.2 of the DSU."[17]

4.7 Brazil submits that pursuant to Article 30 of the SCM Agreement, Article 6.2 of the DSU is applicable to the request for the establishment of a panel in this proceeding. Article 6.2 of the DSU specifies that panel requests shall indicate whether consultations were held and identify the specific measures at issue. Both the letter and the spirit of Article 6.2 of the DSU require that consultations with regard to the specific measures at issue must have taken place in order for a measure to be properly within the terms of reference.[18] Brazil further submits that Article 4 of the DSU requires that parties consult regarding a matter *before* resorting to a panel. Article 4.4 of the DSU provides that if a Member does not respond within a specific period of time "after the date of receipt of the request, *then* the Member that requested the holding of consultations may proceed directly to request the establishment of a panel." (emphasis in original.) Likewise, Article 4.7 provides that "*If the consultations fail to settle a dispute* … the complaining party may request the establishment of a panel." (emphasis in original). Finally, Article 6.2 requires that when requesting the establishment of a panel the complaining party must "indicate whether consultations were held."[19]

4.8 **Canada**, which notes that the subject of its challenge was "export subsidies paid under PROEX…on all exported Brazilian regional aircraft, in whatever amount and regardless of the specific legislative instrument that underlies the programme," accepts that the specific legislative instruments which Brazil wants to exclude from consideration by the Panel were not consulted about by the parties. In its response to a question from the Panel whether it would regard its meetings with Brazil in Rio de Janeiro and Washington D. C. in the first half of 1998 as consultations within the meaning of Article 4 of the DSU, Canada stated that it "agrees with Brazil that the meetings…were not consultations within the meaning of Article 4.4 of the DSU. The specific legislative instruments listed in Canada's request for a Panel were not discussed during these negotiations, as these negotiations were aimed at bringing the subsidies themselves under some form of discipline."

4.9 Canada urges the Panel, however, to reject Brazil's argument that the contested measures are not properly within its terms of reference on two main grounds.

4.10 First, **Canada** argues that Brazil's request has no basis in the DSU, the SCM Agreement or WTO practice. The "matter" referred to in its request for the establishment of a panel in accordance with Article 4.4 of the SCM Agreement was "the payment of export subsidies…under PROEX," and this is the "same prohibited subsidy" on which the parties had consulted. The legislative changes enacted in the period between the two requests did not fundamentally change the character of the "prohibited subsidy" subject to the consultations.

[15]*European Communities - Regime for the Importation, Sale and Distribution of Bananas*; WT/DS27/AB/R; as modified by the Appellate Body report was adopted by the DSB on 25 September 1997.
[16]*Supra* note 13.
[17]*Supra* note 16, WT/DS27/AB/R, para. 142.
[18]*Supra* note 14.
[19]*Ibid*.

4.11 Canada notes that the measures listed in Brazil's preliminary objection are the specific legislative and regulatory instruments underlying the prohibited subsidies with respect to which Canada requested consultations. These specific measures were identified in Canada's request for establishment of a panel in accordance with Article 4.4 of the SCM Agreement and Article 6.2 of the DSU. In Canada's view, the question at issue is the nature and strength of the connection that must exist between the "prohibited subsidy" in SCM Agreement Article 4.1 with respect to which consultations have been requested, and the "matter" in the request for a Panel, as set out in SCM Agreement Article 4.4. Canada asserts that the appropriate test to be applied in determining whether the "matter" in the request for a Panel had been subject to consultations is not whether the request for consultations and the request for a Panel are in all respects identical.

4.12 Canada gives two reasons in support of this proposition. It relies on the statement of the Appellate Body in *India - Patents* that "the claims that are made and the facts that are established during consultations do much to shape the substance and the scope of subsequent Panel proceedings."[20] Canada submits that this observation is equally valid in respect of the facts that are established, and the measures identified, in the period between the request for consultations and the request for a panel.

4.13 Canada's second reason for its proposition is that a request for a Panel must meet the criteria set out in Article 6.2 of the DSU. Thus, whereas it is necessary to list the "specific measures" at issue under Article 6.2 of the DSU, it is not necessary to do so in a request for consultations. Canada acknowledges that Article 4.4 of the DSU is not a licence for a fishing expedition, as a request for a panel cannot be on a matter on which no consultations have taken place. There must be a connection between the two requests. The matter subject to the request for a panel must be rationally connected to the prohibited subsidy subject to the consultations and flow directly from it. Canada reiterated that the matter in its request for a panel is the same as the prohibited subsidy on which consultations were requested. The specific measures identified in the request for a panel in accordance with Article 6.2 of the DSU are rationally and directly connected to the prohibited subsidy on which consultations were requested.

4.14 Canada also argues that the Brazilian challenge, which seems to be based on Article 4 of the DSU, ignores the provisions of Article 4 of the SCM Agreement, which is also cited in its request for consultations. As Article 4 of the SCM Agreement contains special rules applicable to disputes concerning the grant of subsidies and countervailing measures, it should be read together with the relevant provisions of the DSU, as mandated by Article 1.2 of the DSU. The requirements for a request for consultations are found in Article 4.2 of the SCM Agreement, which relevantly provides that "[a] request for consultations…shall include a statement of available evidence with regard to the existence and nature of the subsidy in question," and Article 4.4 of the DSU, which relevantly provides that "[a]ny request for consultations shall be submitted in writing and shall give the reasons for the request, including identification of the measures at issue and an indication of the legal basis of the complaint." Canada submits that the objectives of consultations as set out in Article 4.3 of the SCM Agreement and in Article 4.5 of the DSU are virtually the same. Under both Articles, the stated purpose is to enable the parties to clarify the facts of the situation and to arrive at a mutually agreed solution. If consultations should fail to settle the dispute, parties have a right under both Article 4.4 of the SCM Agreement and Article 6.1 of the DSU to request the establishment of a panel. Canada submits that there are no conflicts between the relevant provisions of the SCM Agreement and the DSU and that they should be interpreted

[20] *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products* , WT/DS50/AB/R, para 94, report of the Appellate Body adopted 16 January 1998.

together in a manner that preserves the comprehensive, integrated nature of the WTO dispute settlement system.[21]

4.15 Canada submits that the facts of this case are different from those in *Argentina - Textiles and Apparel*.[22] There, the matter in dispute was specific duties on footwear that had, by the time the matter came before the Panel, been revoked and replaced by safeguard measures. The complainant, the United States, argued that Argentina was likely to reintroduce the tariffs, and so the Panel should examine the revoked tariffs. Relying on GATT and WTO jurisprudence, the Panel refused to examine a measure that had been revoked even before the Panel was established and its terms of reference had been set. In the present case, the matter at issue has not been revoked or replaced. It is still in force and the legislative and regulatory instruments underlying the PROEX programme are being re-enacted in the form of provisional decrees and ministerial orders on a periodic basis.

4.16 **Canada** submits that the interpreter of a treaty must avoid an interpretation that would lead to an unreasonable or absurd result. Given that PROEX is now governed by a Presidential Decree that must be renewed every month, Brazil's argument, if it were to prevail, would bar examination by the WTO of PROEX altogether, as every request for consultations would be in respect of a specific measure that would have been superseded by another measure at the time that a Panel would be established, meaning that no WTO panel would be able to examine PROEX in its current form at any given time. If Brazil's argument were to prevail, in every case subject to dispute settlement, a responding party would be able to frustrate the WTO dispute settlement system through the simple device of periodic re-enactments of impugned measures. Such an outcome would be manifestly inconsistent with "predictability and security," the central objectives of the WTO dispute settlement system. Brazil's argument would turn the system into a procedural nullity.

B. WHETHER 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

4.17 **Canada** submits that PROEX payments are grants by the Government of Brazil to purchasers of exported Brazilian regional aircraft. These payments reduce the purchaser's net interest rate - sometimes by as much as half of the interest rates available in the market - over the term of a financed transaction. Alternatively, the bonds which are issued by the Brazilian government for such payments may be discounted in the market for a lump sum to be received by the purchaser in the form of a discount on the price of the aircraft. Either way, these payments lower the cost of exported Brazilian regional aircraft for the purchaser. As such, this financial contribution by the Government of Brazil confers a benefit and constitutes a "subsidy" within the meaning of Article 1.1 of the SCM Agreement. Canada further submits that since PROEX subsidies are paid only on the exportation of products from Brazil, they are "contingent on export performance" and therefore prohibited under Article 3.1 of the SCM Agreement.

4.18 **Brazil** concedes that "PROEX interest equalization payments for aircraft constitute an export subsidy." It reaffirms this view in its answer to a question from the Panel by stating that "Brazil has not denied that PROEX interest equalization payments for aircraft fulfil the definition of a subsidy within the meaning of Article 3.1(a). Brazil argues, however, that PROEX is exempt from the prohibition of

[21] *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, paras 64-67, report of the Appellate Body adopted on 25 November 1998.

[22] *Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/R; report of the Panel adopted on 22 April 1998.

Article 3.1(a) by virtue of Article 27 and, totally apart from Article 27, by virtue of item (k) of the Illustrative List."

1. Whether there is a financial contribution by the Brazilian Government

4.19 **Canada** argues that PROEX payments are a direct transfer of funds by the Brazilian government and as such constitute a financial contribution within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. Canada argues, in the alternative, that if the Panel should find that the issuance of treasury bonds and payment by the Government of Brazil on the redemption of such bonds is not a "direct transfer of funds" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement, PROEX payments should be regarded as an indirect financial contribution by a government through a funding mechanism or a private body entrusted or directed, in the sense of Article 1.1(a)(1)(iv) of the SCM Agreement, to transfer payments made by the Government of Brazil upon the redemption of treasury bonds issued under PROEX to the ultimate beneficiaries.

4.20 **Brazil** does not contest that actual PROEX payments constitute a financial contribution by the Brazilian government. In response to a question from the Panel as to whether the "issuance, or commitment to issue, NTN-I bonds represented a "potential direct transfer of funds or liabilities" within the meaning of Article 1.1(a)(i) of the SCM Agreement," Brazil stated that in its view the issuance of a PROEX commitment letter constitutes a "potential direct transfer of funds." Brazil further maintains that since PROEX assistance begins with the letter of approval, the Brazilian Government could be said to grant a subsidy within the meaning of Article 1 of the SCM Agreement at the point when it "issues or enters into a commitment to issue bonds in support of an export transaction."[23] In this respect, Brazil agrees with the arguments advanced by the European Communities as a third party in this dispute.[24]

2. Time at which the financial contribution is made

4.21 **Canada** submits that the point at which a subsidy is determined to exist can have a crucial impact not only on the total "level of subsidies," but also on whether Brazil is meeting its obligations under Article 27 of the SCM Agreement. In this respect, Canada appears to be addressing the arguments presented by the European Communities as a third party in this dispute, as adopted by Brazil.[25]

4.22 Canada argues that the Brazilian government makes a financial contribution at the point when the bonds are redeemed or, in the alternative, at the point when the bonds are issued upon the delivery of the aircraft. It disagrees with the European Communities and Brazil that the Brazilian government makes a financial contribution when "it issues, or enters into a commitment to issue, bonds in support of an export transaction."

4.23 Canada argues that simply entering into a commitment to pay a subsidy at some point in the future cannot constitute a financial contribution within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement, although it agrees with the European Communities that it is necessary to view each grant within the context of the broader commitment under which it is made. That is, each periodic payment under PROEX should be viewed in the context of the commitment in accordance with which such payment is made. An acontextual examination of specific payments under a scheme could make determining the existence of a subsidy impossible.

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[23]Brazil's Second Written Submission, para. 46 and Brazil's Response to Questions From the Panel, No.32.
[24]*See*, the third party submission of the European Communities, para. 5.5 of this report.
[25]*Ibid* at para. 5.4.

4.24 Canada, however, maintains that entering into a commitment when no money has changed hands could not, in itself, be considered a "financial contribution" or a subsidy. This is because commitments, even those by governments, may not always be kept. Canada introduced evidence, which according to it, demonstrated that some airline companies which dealt with EMBRAER, the Brazilian manufacturer of regional aircraft, were of the same view and assumed that it was possible that the Brazilian government may not honour its commitments.

4.25 **Brazil** contests the arguments of Canada regarding when a subsidy is granted. In its submissions, Brazil explained the operation of PROEX with regard to interest equalization payments. In an oral statement before the panel, it also summarized that an application is made and, if the application is in order, that the Banco de Brasil, as agent for PROEX, makes a legally binding commitment. Brazil stated that it would be liable for damages if it did not honour its commitment.[26] Brazil also submitted as an exhibit a legal opinion from a Brazilian legal scholar supporting its position.[27]

4.26 Brazil argued that this commitment is to provide specified PROEX benefits if the transaction is concluded, within a specified time, in accordance with the terms contained in the application. The most important parts of this commitment concern the number of airplanes covered and the price. Both ultimately may be lower than listed in the application, but neither can be greater. When this commitment is issued, Brazil becomes legally obligated to furnish PROEX benefits, and the private parties are free to act in reliance on this commitment. Production is scheduled. Parts and components are purchased. Crew training begins. Both the manufacturer and the airline incur a variety of expenses associated with the production, acquisition, and use of a new aircraft. When actual export occurs, PROEX is paid in the form of NTN-I's, generally 30 non-interest bearing bonds redeemable over the next 15 years. The entire face amount of the 30 bonds is charged to the budget for the year of export.[28]

4.27 Specifically, Brazil argued that the steps taken by the manufacturer include commitments and investments regarding the acquisition of raw materials, supplies and equipment necessary for the production of the aircraft. This involves contractual obligations between the manufacturer and suppliers of such major components as engines, avionics, and landing gear. It may involve increases in the workforce. Positions are scheduled in the workline so that the contracted aircraft may be delivered on time. Finally, the aircraft is manufactured and exported to the purchaser. At the point of export the bonds are issued. At that stage, the manufacturer has incurred all of the expenses involved in producing aircraft ready to be flown.[29]

4.28 Brazil argued that the steps taken by purchasers are not as extensive as those taken by the manufacturer, but they are significant and involve the commitment of resources. These steps include investments regarding the preparation for the start of operations with the new aircraft, including crew training and establishment of a maintenance infrastructure along the points where the aircraft will be flown. Typically schedules are arranged, and promotional expenses incurred. In addition, purchasers are responsible for complying with numerous regulatory requirements of the jurisdictions in which the aircraft will be flown, a process begun before the arrival of the aircraft.[30]

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[26] Brazil's Second Oral Statement, para. 71.
[27] *See* para. 4.33 of this report.
[28] Brazil's Second Oral Statement, para. 72.
[29] Brazil's Response to Questions From the Panel, No. 31.
[30] *Ibid.*

4.29 In these circumstances, Brazil submits that it is clear that the granting of the subsidy occurs at the point at which Brazil makes a legally binding commitment to provide PROEX payments, a commitment on which private actors can and do rely.

4.30 In responding to a question from the Panel asking Brazil to clarify the nature of a “firm order,”[31] Brazil explained that a firm order is a binding contract, imposing rights and obligations on both the buyer and the seller. It represents a commitment by the buyer to purchase an agreed number of aircraft, in accordance with and under the terms and conditions of a binding, legal purchase agreement, and an obligation on the seller to produce and deliver the aircraft to a buyer.

4.31 Brazil further submits that there are no circumstances under which a purchaser (or a seller) may cancel a firm order by its unilateral action. Of course, as with any contract, either party would be excused from performance if the other failed to comply with its obligations under the purchase agreement. For example, a purchaser could cancel a firm order if the manufacturer failed to provide the financing support required by the purchase agreement. In addition, aircraft purchase agreements typically permit the purchaser to cancel a firm order if excusable delays in delivery amount to 300 days or longer, or if non-excusable delays amount to 90 days or longer. The purchase agreement would specify reasons for delay that would be considered excusable. In addition, purchasers typically may cancel firm orders upon the accidental damage or destruction of the aircraft before its acceptance by the purchaser. Brazil submits it is not common for a purchaser of a civil aircraft to cancel a firm order.

4.32 Brazil states that in the event of cancellation of a firm order, a purchaser would be liable for damages under the law of the jurisdiction specified in the purchase agreement. In addition, the purchaser normally would lose all amounts previously paid to the manufacturer. Alternatively, depending upon the terms of the purchase agreement, the purchaser would be liable for liquidated damages.

4.33 Brazil states that a firm order differs from an option only in that the purchaser is not obligated to buy, but if the purchaser elects to do so, the manufacturer is obligated to sell. Thus, an option is equivalent to a “call” acquired by the purchaser. In confidential business information submitted in response to a question from the panel, Brazil provided a letter of commitment that showed that the Brazilian Government makes no distinction between firm orders and options when granting letters of commitment. [32]As such, Brazil disagrees with Canada as to the legal consequences of a letter of commitment. It is of the view that upon the fulfilment of the conditions specified by the Banco do Brasil, the letter becomes irrevocable, in the sense that if the Brazilian government should default, it could be sued for damages in the Brazilian courts. The view of Brazil is confirmed in an opinion prepared by Professor Luiz Olavo Baptisa, who in response to a question[33] from the Panel regarding the legal consequences of a "letter of commitment" stated that :

> "[W]ithin the validity period of the Letters of Commitment and provided there are no pending debts from the exporter [EMBRAER] to the Government of Brazil, it is illegal and not viable the cancellation or the revoking of the interest rate equalization concessions made for the referred to transactions. To accept the cancellation or the revoking of the Letters of Commitment unilaterally done by the administration, other than being clearly illegal, would cause doubts and uncertainties to business and legal relationships and it would also allow the exporter to go to the

[31] Brazil’s Response to Questions From the Panel, No. 29.

[32] Brazil’s Response to Questions From the Panel, No. 31 (Exhibit Bra-15).

[33]The question from the Panel was as follows: "Please explain in what sense the ‘letter of commitment’ represents a binding legal commitment by Brazil. In particular, would the government of Brazil be legally entitled to revoke the letter of commitment before such time as the bonds are issued. If not, please indicate the precise legal instrument and relevant language establishing the legal obligation of Brazil?"

> Courts against the Government of Brazil for indemnification purposes. Therefore it is irrelevant the issue related to the timing of issuance of the NTN-1, [sic], for the issuance of such bonds is nothing else than the materialization of an obligation created upon the issuance of the Letters of Commitment."

4.34 **Canada** submits that the commitment to issue a bond is simply the mechanism by which the Government of Brazil entrusts private entities to make the payment, in periodic instalments or in lump sum, of the subsidies in question to the purchasers of exported Brazilian regional aircraft, in the sense of Article 1.1(a)(iv) of the SCM Agreement. In this sense, the date of the commitment says little about the actual payment of the subsidies that would take place under Article 1.1(a)(iv).

4.35 Canada contends that the European Communities and Brazilian position on the timing of a subsidy is not applicable, at least in the circumstances of this case. On the facts of this case, Canada argues that the phrase "potential direct transfer of funds or liabilities" is irrelevant. In the context of the SCM Agreement, the phrase "potential direct transfer of funds or liabilities" encompasses government practices such as loan guarantees and agricultural crop insurance, but does not include conditional promises or commitments to grant subsidies at some point in the future. The distinction relates to the legal enforceability of a "potential" transfer such as a loan guarantee, as opposed to the contingent nature of a promise or a "commitment" to grant subsidies at some point in the future if certain purchases are made. For example, financial institutions as a matter of course list [loan] guarantees or other contingent liabilities such as insurance commitments as "liabilities." This is not the same as promises or commitments to consider and to give subsidies if purchases are made. The promise to pay subsidies upon future purchase is simply too remote to fit within the terms of "potential direct transfer of funds."

4.36 Canada argues that since PROEX subsidies are not expensed in the Brazilian budget until after the aircraft is delivered, it cannot be argued that, at the time of the order of the aircraft (firm, conditional or optional), the promise to pay a subsidy if an order is exercised amounts to a "potential transfer of funds." The consequences of a failure on the part of EMBRAER to provide financing that was a condition of an order would simply be that the buyer would be relieved of its obligation to purchase the aircraft. Canada further argues that the situation becomes more complicated in the case of option contracts for future deliveries negotiated in a sales agreement. An "option" may be agreed to in recognition of a "commitment" to pay subsidies in the event an option to purchase is exercised by a purchaser. However, such an option may not be exercised. Any "commitment" in respect of such options is not a subsidy unless the option is exercised – that is, a sale takes place – and until the aircraft is delivered – that is, until it becomes necessary for the purchaser to pay for the aircraft and therefore benefit from the subsidies promised. In such instances, the issuance of the Brazilian bonds occurs only after the financing party declares that the goods have been shipped and the exchange contracts have been settled for the total value of the export.

4.37 Canada submits that a "financial contribution" may be found to exist under the PROEX interest equalization scheme at one of only two points, namely (i) where a payment is made pursuant to a NTN-I bond that becomes due; or (ii) where NTN-I bonds are issued to the agent bank at the point of delivery of the aircraft and the cost to government is effectively (though not actually) incurred through expensing in the budget. In the case of the former, the two elements of "subsidy" – a net charge to the treasury and an advantage above and beyond the market are coterminous at the point of each instalment of PROEX subsidies. In the case of the latter, it may be argued that that is also the point at which the terms of a promised subsidy are finally crystallised.

4.38 Canada, however, submits that if the Panel were to decide that a financial contribution is made by the Brazilian government at the point of the issuance of a letter of commitment, then this characterization would significantly increase the level of annual expenditure of export subsidies for the purposes of the second condition of Article 27.4, that is, the requirement not to increase such subsidies. Canada provided calculations based on evidence put forward by Brazil to show that if Brazil is correct in its argument that the issuance of the letter of commitment constitutes the grant of a subsidy, then Brazil has clearly not been in compliance since 1996 with the condition not to increase the level of its export subsidies.

4.39 With respect to the legal opinion submitted by Brazil, Canada submitted that the question of whether domestic legal consequences flow from breaking a commitment to pay export subsidies is not relevant for this Panel. The issue before the Panel is Brazil's obligation, in international law, not to grant and not to maintain export subsidies that are illegal under Article 3 of the SCM Agreement.

3. Whether PROEX payments confer a benefit

4.40 **Canada** argues that the ordinary meaning of "benefit" in context and with a view to the object and purpose of the SCM Agreement accords well with the dictionary definition of the term: a benefit is an advantage.[34] A financial contribution that is not repayable - in other words, a grant - bestows an advantage. Such a contribution, when made by a government, directly or indirectly, amounts to a subsidy. According to the terms of the law under which PROEX payments are made, they are never to be repaid by the beneficiary. As such they amount to outright grants. This alone, in Canada's view, demonstrates the benefit conferred by PROEX.

4.41 Canada argues that since EMBRAER entered into the regional jet market with the certification of the EMB-145 model (now ERJ-145) in 1996, followed by the launch of the 37-seat ERJ-135 in 1997, it has captured over half of the regional aircraft market, and has announced plans to increase its production of regional jets to 12 a month, enough to satisfy, on its own, the demand for regional jet aircraft in this market segment for the foreseeable future. Canada argues that it is PROEX payments which have enabled EMBRAER to become a dominant player in the regional jet aircraft industry and increased its market share. According to Canada, EMBRAER has acknowledged in various documents and communications the benefit conferred by PROEX including in the following news release dated 18 May 1998: "EMBRAER receives up to 3.8 per cent equalization interest rate support from the Brazilian government to help offset high domestic interest rates carried for financing Brazilian exports to foreign buyers."

4.42 Canada argues that the above statement of EMBRAER, while technically correct, is also misleading in one important respect. PROEX payments to foreign purchasers of Brazilian civil aircraft reduce the rate of interest payable by purchasers of regional aircraft by 3.8 percentage points below the rate freely negotiated in the international market by such purchasers. These payments have nothing to do with "high domestic interest rates." Indeed, from at least as early as 1994, PROEX payments have been available where "foreign banks and credit institutions" have financed Brazilian exports.[35]

4.43 Canada maintains that, contrary to the assertions of EMBRAER and the Government of Brazil about "leveling the playing field," these payments reduce the interest rate paid by purchasers of Brazilian

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[34]Canada relies on The Concise Oxford Dictionary of Current English, J.B. Sykes, Ed. (Oxford: Clarendon Press, 1982) at 83; Nolan, Joseph R. and J. M. Nolan-Haley, Black's Law Dictionary, (St. Paul: West Publishing Co., 6th ed; 1990) at p158. Canada notes that the French version of the SCM Agreement notes "*si un avantage est ainsi conféré*." "*Avantage*" translates into "advantage"; Atkins, Beryl T., et. al., Robert Collins Dictionnaire Nouvelle Édition (London: Collins, 1987) at p. 56.

[35]Canada notes that Resolution 2380, which sets out the criteria governing PROEX, specifically states that, "[t]he right to interest equalization is not interrupted, excluded or transferred if the notes relating to the export credit are negotiated abroad."

aircraft to (often non-Brazilian) financiers to levels considerably lower than those that may be obtained in the international financing market. Canada introduced evidence in which airlines such as Comair, Skywest and ASA have acknowledged that Brazilian export subsidies brought down their financing costs by about 1.8 to 3.5 percentage points below market-based costs of financing. PROEX payments thus generally reduce by about half the actual interest paid by such purchasers. As such, they serve as an important part of EMBRAER's success in the market. Canada referred to a number of industry reports that, according to it, supported its argument that PROEX payments conferred a benefit. One industry report dated 10 August 1998 observed that:

> "Of the regional aircraft manufacturers, EMBRAER has the distinct benefit of having the most developed financing programme, sponsored by the Brazilian government, called PROEX. The PROEX programme is underwritten by the government in Brazil to enhance trade in its aircraft and nearly 1,500 other items and products from Brazil. It promised commercial airlines savings of up to $3.5 milion per aircraft. It also allows for a *subsidized interest rate* that is 3.8 percentage points less than the market rate, along with a 15-year term…As mentioned, *the primary advantage EMBRAER has over its competitors is its PROEX financing programme*." [36](emphasis in original)

4.44 Canada also adduced as evidence an investors' circular on EMBRAER issued on 26 August 1998, that noted the following:

> "Dependence on Government Financing: EMBRAER's ERJ-145's most significant orders with American Eagle (for 42 firm orders and 25 options) and Continental (for 25 firm orders and 175 options) were made possible through the use of government financing - the BNDES-Exim and PROEX programmes, designed to assist the country's exporters by extending financing for up to 15 years *at interest rates below what the company would obtain on its own*…[W]e estimate that the bulk of the company's orders to date have been dependent …[sic] on the Brazilian government's willingness (and ability) to finance the sales."[37] (emphasis in original)

Canada concludes by asserting that PROEX payments amount to outright grants whether received in a stream of payments or in a lump sum. There is no obligation to repay any portion of PROEX payments received. These payments reduce the cost of exported Brazilian aircraft to the purchaser, and therefore confer a "benefit" for the purpose of Article 1.1.

4.45 As noted above,[38] **Brazil** does not contest that actual PROEX payments confer a benefit within the meaning of Article 1.1(a)(2) of the SCM Agreement. Brazil adopts, however, the argument of the European Communities that a subsidy is granted within the meaning of Article 1 of the SCM Agreement by the Brazilian government at the point when it "issues or enters into a commitment to issue bonds in support of an export transaction."

4.46 Further, Brazil disputes Canada's claim that "PROEX export subsidies are made for the benefit of foreign purchasers that, for the most part, borrow funds from non-Brazilian institutions on the basis of their own credit risk."[39] Brazil noted, in response to a question from the Panel, that there were only four transactions involving the EMB-120 entered into since 1 January 1995 and that in each the lender was inside of Brazil; in none of the transactions was the lender outside Brazil. Of the 11 transactions

[36]"Regional Jets: Making Props Passe", Industry Report, Warburg Dillion Read, 10 August 1998, at 17-18.

[37]Bear Stearns *Buy Recommendation* for Empresa Brazileira deAeronáutica S.A. EMBRAER, 26 August 1998 at 7. *See* Canadian Documentary Annex tab 32.

[38]*See* para. 4.20 of this report.

[39]Brazil's Second Written Submission, para. 49.

involving the ERJ-145, seven involved lenders inside of Brazil, while only four involved lenders outside Brazil.[40]

4.47 Brazil also submitted that Brazil risk has a dramatic and severe impact on all financial terms and transactions involving Brazil, including export credit terms.[41] Brazil accepts that when the lender is outside of Brazil that Brazil risk does not apply to that lender, but argues that Brazil risk continues to apply to Brazilian exporters as well as Brazilian financial institutions when the lender is outside of Brazil and is reflected in their higher costs.[42] Brazil submitted that EMBRAER itself bears Brazil risk and that the costs it incurs in obtaining credits for its customers outside of Brazil, from lenders outside of Brazil, reflect Brazil risk.[43]

4.48 Finally, Brazil disputes Canada's reference that Brazilian subsidies brought down the financing costs of specific airlines below market-based costs of financing. Brazil stated that it does not make PROEX payments to airlines. PROEX interest equalization payments are made only to financial institutions.[44] Brazil noted that PROEX was preceded by FINEX, which was ended in 1991. FINEX involved what was essentially an open-ended commitment from the Government of Brazil to equalize the spread for Brazil risk. The Brazilian government determined that FINEX, which incurred bad debts totalling over US$3.5 billion by 1991, was too expensive, and decided in 1991 to replace FINEX with PROEX, the terms of which are more limited. Existing FINEX commitments were honoured after the programme's termination.[45] Regarding the transaction involving Sky West, Brazil states it has no first-hand information concerning the statements made by this airline concerning direct payment of subsidies to it from Brazil. If Sky West in fact is receiving such payments, Brazil presumes they are from transactions involving FINEX. In any event, Brazil makes no PROEX payments to airlines themselves.[46] Brazil does not acknowledge that any sales of Brazilian manufactured regional aircraft supported by PROEX interest rate equalization were "made at an interest rate below that of the CIRR rate (taking into account interest rate equalization)."

4. Whether PROEX payments are contingent upon export performance

4.49 **Canada** argues that a subsidy is "contingent ... upon export performance" when it is conditional on or tied to exports; that is, where it is available only on condition that goods are exported. Since PROEX subsidies are paid only on the exportation of products from Brazil, they are "contingent on export performance" within the meaning of Article 3.1(a) of the SCM Agreement.

4.50 Canada maintains that regulations supporting PROEX make it clear that it is contingent upon the exports of goods or services. The Provisional Measure continuing the operation of PROEX does so only with respect to "operations to finance the export of domestic goods or services." Under Article 6 of Monetary Council Resolution No. 2380/97, national treasury bonds for the payment of PROEX subsidies will be issued "only after the financing party or its legal representative declares to the Banco do Brasil that … the goods have been shipped." According to Article 5(2) of Order 33/97, which identifies the goods eligible for PROEX subsidies, "[g]oods shall be eligible for interest equalization only if their [Registration of Export form] has been completed." Indeed, Brazil noted in its official response to questions posed by Canada and other WTO Members at the Committee on Subsidies and Countervailing

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[40] *Ibid* at paras. 49 - 56.
[41] *See* paras. 4.94 - 4.101 of this report.
[42] *See* para. 4.81 of this report.
[43] Brazil's Second Written Submission, para. 53; *see* Section 2.2.
[44] *Ibid* at paras. 49-56.
[45] *Ibid*.
[46] *See* para. 4.110.

Measures that, "[PROEX] provides financing for Brazilian exports and not for sales in the domestic market."[47]

4.51 **Brazil** does not contest that PROEX payments are contingent upon export performance. It, however, contends that they are not prohibited as claimed by Canada.

C. WHETHER PROEX PAYMENTS ARE PERMITTED SUBSIDIES UNDER ITEM (K) OF THE ILLUSTRATIVE LIST OF EXPORT SUBSIDIES

4.52 **Brazil** argues that although the promise of PROEX payments is a subsidy that is contingent upon export performance, it is not prohibited by virtue of item (k) of the Illustrative List of Export Subsidies, which includes within the definition of prohibited subsidies "the payment by [governments] 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." Brazil asserts that the "converse of this statement is that such payments are *permitted* in so far as they are not used to secure a material advantage in the field of export credit terms" (italics in original). Brazil submits that since PROEX payments are not used to secure a material advantage in the field of export credit terms, they are permitted by the Illustrative List of Export Subsidies. Brazil submits that even if it were determined that PROEX is used to secure an advantage in the field of export credits, that alone would not be enough to determine that PROEX is prohibited. It would also be necessary to determine that the advantage is *material*.[48] **Canada** disagrees with Brazil on its interpretation of item (k) of the Illustrative List of Export Subsidies. It submits that the approach adopted by Brazil is not permissible under the SCM Agreement and that, in any event, PROEX payments are used to secure a material advantage in the field of export credit terms. As such, they are not permitted under item (k) of the Illustrative List, even if it were applicable in this instance.

1. Whether item (k) of the Illustrative List of Export Subsidies may be used a contrario

4.53 **Brazil** argues that the interpretation advanced by it is in accordance with Article 31 of the Vienna Convention on the Law of Treaties, which provides that a treaty "shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." Brazil submits that the ordinary meaning of the words "in so far as they are used to secure a material advantage in the field of export credit terms" make clear that when governments grant credits below the cost of funds or when they pay part or all of the costs incurred by financial institutions or exporters in obtaining funds, in so far as these activities are used to secure a material advantage, they are prohibited. A necessary corollary is that when these activities are not so used, they are not prohibited.

4.54 In response to a question from the Panel, Brazil stated that the "material advantage" clause of item (k) constituted an affirmative defence and that it was up to the party seeking to rely on it to demonstrate that its measures are not being used to secure a material advantage in the field of export credit terms. Brazil argues that since PROEX payments are not used to secure a material advantage in the field of export credit terms, it has discharged this burden.

4.55 **Canada** argues that Brazil's characterisation of the first paragraph of item (k) as an exception is incorrect. It contends that contrary to the specific direction of the DSU, as amplified and repeated in WTO jurisprudence by the Appellate Body, Brazil does not "follow all of the steps of applying the

[47] *See* WTO Document G/SCM/Q2/BRA/8, 25 August 1998, at p. 3.
[48] Brazil's First Oral Statement, para. 47.

'customary rules of interpretation of public international law.'" Canada submits the basic rule is that "[a] treaty interpreter must begin with, and focus upon, the text of the particular provision to be interpreted."[49] Canada submits that the applicable provisions are footnote 5 and item (k). Footnote 5 provides that "[m]easures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." Canada argues that Brazil does not articulate the legal basis for its interpretation of the first paragraph of item (k) as providing an exception within the meaning of footnote 5. Brazil simply quotes the first paragraph of item (k) of Annex I and casually notes the a contrario implication that a measure that does not fit squarely within the terms of item (k) is therefore not prohibited. Its legal analysis fails, however, to consider footnote 5.

4.56 Canada asserts that the ordinary meaning of the phrase "measures referred to" in footnote 5 does not encompass an a contrario inference, as Brazil seems to argue. Brazil's interpretation is inconsistent with the direct references in Annex I to measures "not constituting export subsidies."

4.57 Canada argues that there are four exceptions that fit within the meaning of footnote 5. First, the last paragraph of footnote 59 states, in respect of item (e), that "Paragraph (e) is not intended to limit a Member from taking measures to avoid the double taxation of foreign sourced income earned by its enterprises or the enterprises of another Member." This language ("is not intended to limit …") is similar in structure to GATT Article XX ("nothing in this Agreement shall be construed to prevent the adoption … of measures …"). Accordingly, the last paragraph of item (e) provides that the identified measures are not export subsidies and are, therefore, not prohibited under Article 3. The second exception is to be found in item (h) of the Illustrative List, which states "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 when 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 (making normal allowance for waste)." Canada submits that the second subordinate clause of item (h) carves out an *exception* from the scope of the opening clause of item (h) and that it is this type of exception which is contemplated by footnote 5. The third exception, according to Canada, is to be found in the second subordinate clause of the first sentence of item (i), which contains similar language ("provided, however …") used in item (h). Canada further submits that the fourth and last exception in the Illustrative List is to be found in the second paragraph of item (k) and not in the last paragraph as contended by Brazil.

4.58 Canada submits that a measure that meets the criteria of item (k) is *ipso facto* an export subsidy and therefore prohibited. In respect of such a measure, it is not necessary for a complainant to establish that the export credit in question is a "subsidy" within the meaning of Article 1, or that it is "contingent on export performance." Rather, a complainant may simply demonstrate that a government export credit is granted below its cost of funds so as to "secure a material advantage in the field of export credits"; such an export credit would be prohibited. It does not follow, however, that where a measure does not fit squarely within the first paragraph of item (k), it is, by virtue of that fact alone, not prohibited.

4.59 Canada argues that if the Brazilian argument were accepted, it would turn the Illustrative List into an exhaustive list of export subsidies, as a subsidy which does not meet the exact criteria of an item in Annex I would not be prohibited. Such an outcome would not accord with the ordinary meaning of the terms of the Illustrative List, is not supported by the negotiating history of the Illustrative List, and would lead to a manifestly absurd or unreasonable result.

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[49] *United States – Import Prohibition of Certain Shrimp and Shrimps products*, WT/DS58/AB/R, para. 114, report of the Appellate Body adopted on 6 November 1998.

4.60 Canada submits that Annex I, by its very terms, is an illustrative list of export subsidies. Nothing in Article 3 indicates that the Illustrative List is exhaustive of the universe of export subsidies. Indeed, the use of the word "including" in Article 3 clearly indicates that there are measures or activities other than those listed in the Illustrative List that could be caught by that Article; that is, there could be subsidies that do not meet the exact definitions set out in Annex I that would, nevertheless, be prohibited under Article 3.

4.61 Canada argues that the negotiating history of the Illustrative List confirms its view. The origins of the Illustrative List can be found in a proposal submitted by the Government of France to the Working Party established to bring into force the provisions of Article XVI:4 of the GATT 1947.[50] Canada submits that the Working Party considered and adopted a list of measures that were generally to be considered as subsidies in the sense of Article XVI:4. It agreed, however, that "this list should not be considered exhaustive or to limit in any way the generality of the provisions of paragraph 4 of Article XVI."[51] Canada argues that for the purposes of Article XVI:4, if a practice fell within the examples set out in the Illustrative List, it would be considered an export subsidy. If it did not, however, it did not mean that it was not an export subsidy; rather, an independent analysis under Article XVI or, subsequently, under the Tokyo Round Subsidies Code had to be undertaken to determine whether the practice was an export subsidy.

4.62 Canada contends that the first paragraph of item (k) is no different. According to this paragraph, the payment by a government "of all or part of the costs incurred by exporters or financial institutions in obtaining credits" is clearly prohibited by Article 3 where the payment is "used to secure a material advantage in the field of export credit terms." If, however, such payment does not fit item (k) squarely – if Brazil can show that no "material advantage" was bestowed – a complaining party can still establish that the payment is a subsidy, that it is contingent on export performance, and that it is therefore prohibited under Article 3.

4.63 Canada insists that Brazil's approach, if it were to hold, would produce a manifestly absurd result. The absurdity of the Brazilian argument is highlighted by the following example: item (a) provides that "[t]he provision by governments of direct subsidies to a firm or an industry contingent upon export performance [shall be prohibited]." If Brazil's interpretation prevails, the a contrario operation of item (a) would exclude indirect export subsidies, subsidies provided through non-governmental agents, and subsidies granted to natural persons from the scope of Article 3. That is to say, Annex I would contradict, implicitly and explicitly, the very terms of Article 3.

4.64 **Brazil** considers that the interpretation of item (k) advanced by Canada and the European Communities would render the words of item (k) meaningless and conflict with the view expressed by the Appellate Body in the *Gasoline* case: "One of the corollaries of the 'general rule of interpretation' in the *Vienna Convention* is that interpretation must give meaning and effect to all the terms of a treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs to redundancy or inutility."[52] A reading that did not accept these words of limitation in their ordinary meaning would reduce them to total inutility. The interpretation of Canada and the European Communities ignores the ordinary meaning of the words and is "the equivalent of eliminating the clause entirely and placing a full stop after the word "credits" in the next to last line of the first paragraph of

[50] *Report of the Working Party on Subsidies*, Contracting Parties, Seventeenth Session, November 1960, L/1381 at pp. 4-7.

[51] *Ibid.*

[52] *United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, p 23, report of the Appellate Body adopted 20 May 1996.

item (k)." Such an interpretation, in its view, is contrary to the customary rules of interpretation of public international law as enunciated by the Appellate Body in the *United States - Gasoline* case.

4.65 Brazil submits that the "material advantage" clause of item (k) does not mean that *any* measure that does not confer a material advantage would not be prohibited. It means only that measures that otherwise would be prohibited by item (k) would not be prohibited. Specifically, the first paragraph of item (k) refers to two practices and two practices only: first, it refers to the grant by governments of export credits at rates below those which they actually have to pay for funds, and second, it refers to the payment by governments of all or part of the costs incurred by exporters or financial institutions in obtaining credits. Both of these practices are prohibited by the first sentence of item (k) "in so far as *they* are used to secure a material advantage in the field of export credit terms." In other words, the "material advantage" clause of item (k) refers to and limits only the two practices specified earlier in the same paragraph. Brazil argues that the "material advantage" clause does not "exempt from the prohibition of Article 3 any and all practices of whatever kind that happen not to confer a material advantage." It submits that Canada's view that it is only the second paragraph (the OECD safe-haven clause) which provides an exception to the prohibition of the first paragraph is implausible, as such a reading of the item completely ignores the specific treaty language that is the "material advantage" clause. Canada's interpretation of the item would be no different if a full stop, or a period, appeared after the word "credits" in the second to last line of item (k), with all of the remaining words deleted. As a result, Brazil argues that Canada's interpretation is not consistent with the customary rules of interpretation of public international law, as codified in the *Vienna Convention on the Law of Treaties*, is not consistent with the holding of the Appellate Body in the *Gasoline* case and other cases, and does violence to the bargain reached between developed and developing countries in the Uruguay Round.[53]

4.66 Brazil argues that the "safe haven" of the second paragraph of item (k) does not negate or derogate from the plain meaning of the text of the first paragraph. The ordinary meaning of the text of the second paragraph is that a Member may engage in one of the activities specified in the first paragraph, even if in doing so it gains a material advantage, provided it is in conformity with the OECD Guidelines referred to in the second paragraph. In essence, there are three tiers to item (k). The first tier specifies the practices that constitute prohibited export subsidies. The second tier adds the "material advantage" clause, the ordinary meaning of which is that it qualifies the prohibition of the first tier. The third tier is the second paragraph which adds another limitation on the first two tiers, by providing that a practice in conformity with the relevant provisions of the OECD Guidelines shall be permitted regardless of whether it is used to confer a material advantage.

4.67 Brazil submits that to the extent that the "material advantage" clause defines an area of government activity and provides that it is permitted, it does indeed derogate from Article 3.1(a). There is nothing alarming about this. Footnote 5 provides that, "[m]easures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." The "material advantage" clause is one of those measures. There are others. For example, item (i) specifies that the remission or drawback of import charges will constitute an export subsidy prohibited by Article 3.1(a) if it is "in excess of those levied on imported inputs that are consumed in the production of the exported product." The converse of necessity is true: the remission or drawback of import charges *not* in excess of those levied on imported inputs that are consumed in the production of the exported product is not prohibited. No other reading of the text of the "in excess" clause of item (i) makes sense.

4.68 Addressing the argument of Canada that its interpretation of item (k) would turn the illustrative list of export subsidies into an exhaustive list and produce absurdities such as the one claimed in

[53]Brazil's Second Oral Statement, paras. 51-53.

paragraph 4.47 above, Brazil argues that Canada is mistaken and has misconstrued its interpretation of item (k). Brazil submits that the limiting language in item (a), which is the counterpart to the "material advantage" language of item (k) is not "direct." It is "contingent upon export performance." The "provision by governments of direct subsidies to a firm or an industry" is a subsidy, but it is not prohibited subsidy *unless* it is "contingent upon export performance" (italics in original).[54]

4.69 Brazil also referred to the duty drawback provisions of item (i) of Annex I. Brazil argues that item (i), as Canada has noted, contains a "provided, however" clause which defines activity that is not an export subsidy. However, item (i) has more. In its very first sentence it defines the prohibited drawback payments as those "*in excess* of those levied on imported products that are consumed in the production of the exported product." Drawback payments *not* in excess of those levied on imported products consumed in the production of an exported product are *not* prohibited.[55]

4.70 Brazil also argues that item (h), as Canada notes, also contains a "provided, however" clause, but it too contains more in its first sentence. This sentence specifies that the exemption, remission or deferral of prior-stage cumulative indirect taxes on exported products that are "in excess of the exemption, remission or deferral of like prior-stage cumulative indirect taxes" sold for domestic consumption constitutes a prohibited subsidy. Brazil submits that the only logical reading of this language is that exemption, remission or deferral for exports that is *not* in excess of those imposed for domestic consumption is *not* prohibited.[56] (emphasis in original)

4.71 Brazil submits that the "material advantage" clause of the first paragraph of item (k) serves the same function as these provisions and that it defines and limits the prior portion of the sentence.[57]

2. Whether PROEX payments are payments within the meaning of item (k) of the Illustrative List

4.72 **Canada** submits that although PROEX subsidies are related to export credits, they do not constitute a "payment" by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits" within the meaning of the second clause of the first paragraph of item (k), given their nature as periodic cash grants to the purchasers of civil aircraft.

4.73 Canada submits that its interpretation of the first paragraph of item (k) is as follows. The first part of item (k) refers to a situation where a government lends funds at an interest rate that is below the rate it would pay for raising such funds. The phrase "the costs incurred … in obtaining credits" in the second part of item (k) refers to a similar situation, but with private financing. That is, where an exporter or a financial institution obtains credits at rates higher than the rates at which it would lend to a purchaser and incurs a cost as a result, and a government pays for all or part of this difference.

4.74 Canada submits that its interpretation is consistent with the response given by the Counsel for Brazil to a question from the Panel. He stated that PROEX payments were not made to cover the development costs of EMBRAER aircraft. He also stated that these export subsidies were not paid to cover EMBRAER's higher cost of funds, but rather they covered the costs incurred when EMBRAER raised the funds necessary to finance the sales of its aircraft. Canada argues that, implicit in this, is Brazil's interpretation of the phrase "payment by [governments] of all or part of the costs incurred by

[54]*Ibid* at paras. 42-44.
[55]*Ibid* at paras. 47-49 and 54-56.
[56]*Ibid*.
[57]*Ibid*.

exporters or financial institutions in obtaining credits" in item (k): the costs incurred by – in this case – the exporter, EMBRAER, in raising funds to finance the purchase of its product.

4.75 Canada submits that PROEX subsidies have little to do with EMBRAER's cost of raising funds to provide financing. Rather, PROEX export subsidies are in practice paid when non-Brazilian purchasers finance their purchases through non-Brazilian lenders. Canada gives the example of Mesa Airlines, an American regional airline and a purchaser of EMBRAER aircraft.[58] Mesa financed its purchase through CoreStates Bank, a US bank. EMBRAER did not provide the financing in that transaction, but the transaction received PROEX support. The PROEX subsidy in that case was, therefore, not a "payment" of the costs incurred by the exporter, EMBRAER within the meaning of item (k) of the Illustrative List. PROEX export subsidies are not payments to cover the costs incurred by exporters or Brazilian financial institutions in raising funds used for financing purchases. They are simply cash grants made for the benefit of purchasers of Brazilian exported products. They do not, therefore, fall within the first paragraph of item (k).

4.76 **Brazil** submits that PROEX export subsidies constitute a payment by the Government of Brazil of all or part of the costs incurred by EMBRAER or financial institutions in obtaining credits within the meaning of item (k) of the Illustrative List. With respect to Canada's argument that PROEX payments do not relate to costs incurred by *Brazilian* financial institutions in obtaining credits, Brazil argues that the relevant language of item (k) refers to "financial institutions," not to "Brazilian financial institutions" or financial institutions of any nationality. At any rate, contrary to the assertions of Canada, in most of the transactions concluded by EMBRAER, "the lender was a Brazilian lender inside Brazil, not a financial institution outside Brazil."

4.77 With respect to Canada's argument that PROEX subsidies has little to do with *EMBRAER's* cost of raising funds, and in response to a question from the Panel,[59] Brazil stated that it is undisputed that in international transactions involving the sale of aircraft, it is the exporter who has to provide or arrange for financing. The financial package offered by the exporter is second only to the characteristics of the aircraft in making the sale. Brazil asserts that the Canadian manufacturer of regional civil aircraft, Bombardier, has, or is in the process of establishing its own subsidiary that will provide or arrange for financing to its customers. EMBRAER does not have such a subsidiary, but is not relieved from the necessity of putting together a financing package for its customers that is competitive with what Bombardier offers. In doing so, it incurs costs, such as those documented by Dr. Finan with regard to the Continental Express transaction. In this situation, EMBRAER may be viewed as "obtaining" funds with which to provide a financial package, or "obtaining" an acceptable package from other sources for the benefit of its customers.[60]

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[58]Canada also gives the examples of three other airlines, namely Comair, Skywest and Trans State Airlines. In the case of the first two airlines, Canada argues that PROEX payments "simply reduced the rate of interest paid, to one significantly below that prevailing in the international market. Canada claims that PROEX export subsidies were not, in those cases, "payments" made to defray "costs incurred" by the exporter, EMBRAER, within the meaning of item (k)." In the case of the last transaction, a term issued by the financing bank, Bank of America, Canada claims that "offered to arrange the payment of PROEX export subsidies, either in lump sum or in instalments over the life of the proposed financing. The offer of payment of the PROEX subsidies was not conditional on EMBRAER providing the financing. Nor was it conditional on a Brazilian financial institution providing the financing."

[59]The question from the Panel was as follows: "Please explain fully your view that PROEX payments are payments of 'costs incurred by exporters or financial institutions in obtaining credits': In what sense does EMBRAER or a financial institution, whether Brazilian or other, "obtain" credits? Could it not rather be said in this case that financial institutions 'provide' credits which are 'obtained' by the purchaser?"

[60]"Brazil Risk" is explained in detail in paras. 4.94 - 4.101.

4.78 In its response to a question from the Panel whether there was a difference between the "cost of credit" and "the cost of obtaining credits,"[61] Brazil stated that in the context of item (k), there is no meaningful distinction between the cost of credit and the cost of obtaining credit. To "obtain," according to Webster's Third International Dictionary, is "to gain or attain possession." A synonym is "get." When one "gets" a loan one "obtains" it. That the cost of this action may be spread out over the life of the loan does not change the fact that it is a cost of obtaining the loan in the first instance. The "risk spread" added to the basic interest rate is certainly a cost to "obtain" the credit. This cost varies from borrower to borrower depending on their respective creditworthiness. The "cost of credit" is the basic cost charged for borrowers with the best credit ratings. A Brazilian company or financial institution carries the "risk spread" of Brazil on top of its own credit rating. This is a cost to "obtain" the credit, which would not be granted unless the borrower agreed to pay for it, on top of the basic "cost of credit," over the life of the loan. Other borrowers with better credit ratings - or that do not carry a high country "risk spread" - would not have to pay for these costs. Therefore the "risk spread" could not be interpreted as part of the "cost of credit," since it is applied in a differentiated manner.

3. Whether PROEX payments are used to secure a material advantage in the field of export credit terms

4.79 **Brazil** contends that although PROEX payments confer a benefit within the meaning of Article 1 of the SCM Agreement, "they are not used to secure a material advantage in the field of export credit terms." Brazil notes that the term "material advantage" is not defined in the Agreement, and argues that the words should be given their ordinary meaning. Brazil relies on the Webster's Third New International Dictionary of the English Language, which defines "material" as "being of real importance or great consequence." "Advantage" is defined as "a more favorable or improved condition." Thus, any more favourable or improved condition secured by the Brazilian aircraft exporter or financial institutions as a result of PROEX must be of real importance or of great consequence, before they would be prohibited under the SCM Agreement.

4.80 Brazil argues that the concept of material advantage includes comparison – advantage *vis-à-vis* someone or something. Two points of comparison are relevant to the determination in this dispute of whether PROEX is used by Brazil to secure a material advantage in the field of export credit terms: (i) Brazil risk and (ii) Canada's subsidies to Bombardier. On either measure alone, PROEX provides no material advantage. To demonstrate that PROEX subsidies do not secure a material advantage "in the field of export credit terms", Brazil introduced as evidence a report prepared by Dr. Finan ("Finan Report").

(a) Summary of the Evidence Presented by Dr. Finan

4.81 The Finan Report states that this dispute involves a unique set of facts and circumstances that must be acknowledged in order to correctly evaluate material advantage in the field of export credits, particularly as it relates to regional aircraft exports.[62] First, the dispute is between a developed country and a developing country both of which maintain export subsidy programmes that benefit regional aircraft exports. Second, the dispute concerns the export of capital goods, which have a different set of financing requirements relative to non-capital goods or agricultural products. Financing is of a longer term (15 years or longer) and is based on "buyer credits." Third, the dispute concerns the only two manufacturers

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[61]The question from the panel was phrased as follows: "In what sense can interest rate payments be seen as costs of 'obtaining' credits as opposed to costs of carrying them? Is there a distinction between the 'cost of credit' and the 'cost of *obtaining* credits'?"

[62]Finan Report, pp. 1.1 – 1.3.

of 50-seat regional jet aircraft in the world. Bombardier was the first to manufacturer this type of aircraft. Canada defined the terms for export credits that Brazil was required to match. It concludes that Brazil cannot match Canada's terms in kind.[63]

4.82 The Finan Report identifies the major elements of export credit terms as (1) the export price of the aircraft, (2) the term of financing, and (3) interest rates, including factors that determine the interest rate.

4.83 In evaluating material advantage, the Finan Report evaluated two types of Canadian subsidies, direct and indirect, that benefited Canada's export credit terms.[64] The Finan Report assesses whether there is a material advantage given to Brazil through the export credits of the PROEX programme. To do so, the Finan Report compares PROEX benefits to the aircraft buyer with the benefits provided to the aircraft buyer by all of Canada's subsidy programmes that directly or indirectly affect export credit terms.[65]

4.84 The Finan Report submits that evaluating material advantage requires evaluating one country's set of export credit terms relative to another country's set of export credit terms by applying a consistent methodology appropriate under the facts and circumstances. The Finan Report further states that determining the present value of total subsidy benefits is the most reliable way to determine material advantage in this dispute, with the present value of PROEX benefits compared to the reduction in the present value of financing costs resulting from all of Canada's export supports.[66] The Finan Report argues that Bombardier, its suppliers, and its customers have been and are subsidized by the Government of Canada and the Provinces of Ontario and Québec through a variety of programmes; Bombardier was the first to enter the regional jet market, and therefore Canada was able to define any and all export credit terms. The Finan Report claims that Brazil was forced to match Canada's terms in order to be competitive; and many regional aircraft buyers have weak credit ratings, and thus rely heavily on the export credit packages offered by official export credit agencies.[67] The Finan Report submits that, because of Brazil's weak credit rating and sovereign risk element, Brazil is unable to match Canada's export credit terms in kind.[68]

4.85 The second part of the Finan Report discusses the PROEX programme, evaluates why it is necessary in Brazil's situation, and details Brazil risk. The Finan Report concludes that a Brazilian commercial entity cannot avoid bearing the additional cost of Brazil sovereign risk when it raises financial capital or finances a purchase or a sale.[69]

4.86 The third part of the Finan Report evaluates the effect of PROEX on the Brazilian regional aircraft market and concludes that PROEX does not provide Brazil with a material advantage in the field of export credit terms for exports of regional aircraft. Based on data provided by EMBRAER, the Brazilian aircraft manufacturer, the Finan Report details the firm orders for all manufacturers of the 50-seat regional jet, both before and after PROEX came into effect (there are only two manufacturers of the 50-seat regional jet: Bombardier of Canada and EMBRAER of Brazil). The Finan Report concludes that

[63] *Ibid* at p. 3.20.
[64] *Ibid* at p. 1.8.
[65] *Ibid* at pp. 1.8 - 1.9.
[66] *Ibid* at pp. 1.9 – 1.17.
[67] *Ibid* at p. 1.11.
[68] *Ibid* at p. 1.13.
[69] *Ibid* at pp. 2.1 – 2.4.

even after PROEX began to be applied to exports of regional aircraft, Bombardier's CRJ still captured 57 per cent of the firm orders.[70]

4.87 The Finan Report also attempted to quantify the Canadian export subsidies received by Bombardier or its suppliers, although it notes at page 3.23 that benefits presented in the report "constitute only a sample, or subset, of the total benefits conveyed to Bombardier by the Government of Canada and the provincial governments of Ontario and Québec" because of a lack of transparency in Canada's programmes.[71] According to the Finan Report, Canada's total direct and indirect benefits provided to Bombardier ranged between US$1,883 thousand to US$2,446 thousand.

4.88 The Finan Report states that based on the Canadian supports, the total present value for reduced financing costs per CRJ (Bombardier's 50 seat jet aircraft) to be delivered in 1998 ranges from US$4.4 million to US$6.0 million. Again, Brazil argues these figures are only a subset of the actual figures, which may be much higher.[72] Hence, the Finan Report concluded that EMBRAER through the PROEX programme did not achieve a material advantage in export credit terms relative to Bombardier.[73]

4.89 The Finan Report provided six appendices to support its presentation, consisting of market return benchmarks, Bombardier regional aircraft deliveries, EMBRAER's cost of capital analysis, EMBRAER-Brazil specific risk, calculation of present value of Canadian subsidies, and a description of the method applied to determine material advantage.

4.90 **Brazil** argues that given the language of the SCM Agreement, together with the unique set of facts and circumstances surrounding this dispute, there are three methods of determining that PROEX provides no material advantage: (1) if the lender is situated in Brazil, because there is Brazil risk in the cost of funds for Brazilian lending institutions; (2) if the lender is outside Brazil, because EMBRAER bears increased costs associated with obtaining financing for its exports due to Brazil risk; and (3) independent of the location of the lender, i.e., even if the lender is outside Brazil, Canada's subsidies to Bombardier are greater than the assistance provided by PROEX.[74]

4.91 Relying on Dr. Finan's presentation at the Second Panel Meeting, Brazil states that there are four categories of transactions involving EMBRAER aircraft purchases: (1) purchaser is located inside Brazil and financed by a Brazilian bank; (2) purchaser is located inside Brazil and financed by a non-Brazilian bank; (3) purchaser is located outside Brazil and financed by a Brazilian bank; and (4) purchaser is located outside Brazil and financed by a non-Brazil based financing source.[75] Brazil argues that all deals financed by a bank in Brazil contain Brazil risk (i.e., situations 1 and 3).[76] Brazil also argued that there are no purchasers inside Brazil financed by a non-Brazilian bank that benefit from PROEX (i.e., situation 2).[77] Brazil also argues that deals outside of Brazil contain Brazil risk (i.e., situation 4).[78] Brazil contends the first two categories of transactions are not at issue in this dispute (i.e., situations 1 and 2). According to Brazil, with respect to the latter two categories of transactions (i.e. situations 3 and 4), deals financed by a bank in Brazil and deals financed outside Brazil both contain Brazil risk-related costs. In such deals,

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[70]*Ibid* at pp. 3.1 – 3.2; the table is found at p. 3.2.
[71]*Ibid* at p. 3.9.
[72]*Ibid* at p. 3.23.
[73]*Ibid* at pp. 3.22, 3.25; the table is found at p. 3.25 of the Finan Report.
[74]Oral Presentation of Dr. William F. Finan at Second Panel Meeting, p. 3.
[75]Oral Presentation of Dr. William F. Finan at Second Panel Meeting (Graphic Presented to the Panel).
[76]Brazil's Response to Questions From the Panel, No. 12.
[77]*Ibid*.
[78]*Ibid*; Dr. Finan's Oral Statement at the Second Meeting of the Panel (statement contains confidential business information).

the Brazil risk-related costs are an amount greater than PROEX's assistance. According to Brazil, when compared to the subsidies given to Bombardier, clearly PROEX also provides no material advantage. [79] Therefore, when the two are considered together, it is clear that it is Canada's programmes, not Brazil's, that secure a material advantage in the field of export credit terms.

4.92 **Canada** submits that PROEX payments are used to secure a material advantage in the field of export credit terms. In Canada's view, a material advantage is "secured when a government provides export credit at rates that are lower than those prevailing in the international financing market. A material advantage is secured, in addition, when payments by governments to exporters or financial institutions result in interest rates that are lower than those prevailing in the international market." Canada submits in that connection that the relevant rates to be considered in the international market are the London Inter Bank Offer Rate (LIBOR) or the United States (US) Treasuries rate plus a spread that reflects the credit risk of the transaction.[80]

4.93 Canada confirms its view that the appropriate benchmark is either LIBOR or US Treasury rates in its response to the following question from the Panel: "Should material advantage be assessed by reference to (a) whether the export credit terms with respect to a given transaction are improved by virtue of the government payment or (b) whether the export credit terms available to a purchaser for a given transaction benefiting from a payment are better than the terms that would have been available to that purchaser with respect to transactions involving competing products?":

> "[N]either (a) nor (b) is appropriate for assessing material advantage. With respect to (a), "the government payment" in question could be applied in combination with an officially supported export credit. In this sense, the question would not be whether any export credit terms for a given transaction have been improved, but whether the final export credit terms are in line with terms and conditions available in the international financing market. Under (b), the point of reference would continue to be the export credit terms available to a competing product in line with the international financing market and clearly not subsidised credit terms for other products. To measure export credit terms as against subsidised credit terms would be unworkable: an export credit could be found to be an export subsidy if measured against one competing product, but not so against another. It is Canada's position that material advantage should be assessed with respect to the international financing market. The international financing market is defined by the benchmarks that have been discussed by Canada (LIBOR or US Treasuries plus a spread that reflects the credit risk of transaction)."

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[79] *Supra* note 77.

[80] In a floating rate transaction, the lender sets an interest rate that will be moved up or down in relation to general movements in interest rates in the wider economy. In the floating-rate aircraft financing transactions, the benchmark used (to reflect the "general movements in interest rates") is the three-month or the six-month LIBOR. LIBOR is the rate of interest at which banks offer to lend money to one another in the "wholesale" money markets in the City of London. Although LIBOR figures are available for the major currencies, the US dollar tends to be the currency of choice in international financing activities related to aircraft. They tend to quote interest rates they would charge as "basis points (or bps) above LIBOR." These "basis points above LIBOR" are what is known as the "spread" charged by a lender -- the additional charge that reflects the credit risk of the transaction. This credit risk is based on the credit quality of the borrower and incorporates other criteria determined by the lender to be relevant to the transaction, such as the value of any asset being financed, any security interests in the assets of the borrower, or any third-party guarantees. If three-month LIBOR were (for example) six per cent, a bank may choose to lend to a purchaser at (for example) seven and a quarter per cent, or 125 basis points (bps) above three-month LIBOR. In fixed-rate transactions, the borrower's interest payments are set at the outset of the transaction and are not subject to variation in the underlying interest rate. In aircraft financing transactions (which are mostly US dollar-denominated) the benchmark used is US Treasury.

(b) "Brazil risk"

4.94 **Brazil** submits that in financial markets, the debt securities of all governments bear a “sovereign risk” premium. This risk premium reflects the views of participants in those markets as to the likelihood of repayment on schedule. Generally the debt securities of the United States bear no risk premium, and, as a result, the sovereign risk of the securities of other governments may be measured as the amount of additional interest markets demand for those securities compared to the securities of the United States. For developed countries, such as Canada, this premium is extremely low or non-existent. For developing countries, such as Brazil, this premium can be quite high. The risk premium is normally referred to in terms of “basis points,” with 100 basis points equalling one per cent. As described in detail in the Finan Report,[81] which has been tendered in evidence by Brazil, the risk premium for securities issued by the Government of Brazil in recent years has varied between a high of 1,300 basis points in the first quarter of 1995 and a low of 400 basis points in the third quarter of 1997. However, by the third quarter of 1998, Brazilian sovereign risk rose again to over 1,000 basis points, an increase in the spread for Brazil risk of 6 percentage points or 600 basis points due to the Asian debt crisis and the Russian debt default and generally the volatility in the financial markets.

4.95 Brazil further notes that during the same period, Canada’s spread remained virtually unchanged. The reality with which Brazil and other developing countries must live is that with globalised financial markets, when others catch a cold, they may catch pneumonia. The risk markets assign to both Brazilian and Canadian debt is reflected in the ratings they receive from financial services. According to Standard & Poor’s, the rating on Brazil’s foreign currency denominated debt is BB-, while the rating on Canada’s is AA+. What this means in real terms is that in the third quarter of 1998 the yield on the Brazilian 10-year C-Bond was 15.75 per cent, while the yield on the Canadian 10-year bond was 5.25 per cent, or 10.5 percentage points lower. Those 10.5 percentage points represent the difference between Brazil risk and Canada risk.

4.96 Brazil submits that the "Brazil risk" has a dramatic and severe impact on all financial terms and transactions involving Brazil, including export credit terms. The adverse impact in the area of export credit terms is particularly severe in the regional aircraft industry, where market custom, established by developed countries long before Brazil became a factor, is that the manufacturer supports the financing of its aircraft. Brazil submits that one consequence of Brazil risk is that EMBRAER cannot compete in providing manufacturer’s supports that match in-kind Bombardier’s.[82] Brazil submits that aircraft trade is conducted in US dollars, which means that direct financing must be made available in U.S dollars. The OECD rate for US dollars is in the vicinity of 6 per cent. The OECD Agreement permits members to provide financing at the OECD rate for US dollars regardless of a member's cost of acquiring dollars. While item (k) of the Illustrative List essentially extends this permission to all WTO Members regardless of whether they are members of the OECD, for Brazil and other developing countries, the cost of acquiring dollars is very high because of the compensation demanded by lenders for "Brazil risk [or developing country risk].”

4.97 First, Brazil argued at the first meeting of the Panel[83] that paragraph (k) makes clear that the developed country Members of the WTO that are also Members of the Organization for Economic Cooperation and Development – the OECD – have taken care of themselves. It does so by providing that an export credit practice which is in conformity with the interest rates provisions of “an international undertaking on official export credits to which at least twelve original Members to this Agreement are

[81]The credibility of the Finan Report has been contested by Canada; *see* paras. 4.122 and 4.139.
[82]Finan Report, p. 3.20.
[83]Brazil’s First Oral Statement, para. 21.

parties as of 1 January 1979" shall not be considered to be a prohibited export subsidy. This is a reference to the so-called OECD Agreement or Guidelines.

4.98 Brazil argued that developing countries did not bargain for the OECD "alternative" in the Uruguay Round. They are not members of the OECD. They have no voice in the OECD. Developing countries bargained for the temporary exemption of Article 27, and for the "material advantage" language of item (k) precisely because, when Article 27's protection expires, they needed something they could afford in view of the fact that the developed countries had their own self-designed exemption, which is presently in the second paragraph of item (k).

4.99 Brazil asserts that while it could take advantage of the OECD provisions in paragraph (k) of Annex I by borrowing US dollars for approximately 16 per cent and lending them for approximately 6 per cent, absorbing a 10 per cent loss in the process, this is hardly a viable alternative from a fiscal viewpoint. PROEX is more affordable to Brazil.[84] Brazil further submits that apart from the high cost of borrowing dollars, the OECD exemption would not have helped it to counteract the incentives provided by Canada to Bombardier, especially considering that under the OECD Guidelines, the maximum term for aircraft financing permitted to OECD members is 10 years, yet Canada established the practice in the regional aircraft industry of granting 15 year financing to Bombardier.[85] Brazil further notes that "developing countries did not bargain for the OECD "alternative" during the Uruguay Round…[T]hey bargained for the temporary exemption of Article 27, and for the "material advantage" language of item (k) precisely because, when Article 27's protection expires, they need something they could afford in view of the fact that the developed countries had their own self-designed exemption which is presently in the second paragraph of item (k)." In response to a direct question from the panel,[86] to support its position that developed country Members bargained for the "material advantage" language of item (k), Brazil submitted a July 7, 1990 proposal made during the Uruguay Round by a developed country to delete the 'material advantage' language of item (k). Brazil and other developing countries opposed this initiative. The proposal was rejected and the language remained in item (k).[87]

4.100 Brazil submits that no private institution in any country can expect to borrow at rates below those made available to its government. The risk premium markets assign to private borrowers includes the sovereign risk of their governments in addition to their own enterprise-specific risk. Thus, any Brazilian exporter or financial institution attempting to obtain funds for export credits is handicapped from the start with a 10.5 per cent or 1,050 basis point risk premium compared to a Canadian counterpart, or a counterpart in other developed countries. Relying on the Finan report, Brazil asserts that to support the financing of EMBRAER aircraft, EMBRAER and Brazilian financial institutions must pay a premium of

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[84]In this respect, the Panel posed the following question to the parties: "Brazil argues in its first oral statement (paras. 22-25) that developing country Members may not in practice act in accordance with the OECD Arrangement because it is too expensive for developing countries to raise dollars at a high rate of interest reflecting sovereign risk and then lend those dollars at Arrangement interest rates. The Arrangement, however, applies to "official support" whether given by means of "direct credits/financing, refinancing, *interest rate support*, guarantee or insurance" (emphasis added). In the case of interest rate support, the supporting government presumably need not either provide the principal amount itself or guarantee its repayment. Accordingly, how is Brazil's argument relevant in the context of "interest rate support"? Brazil's response was as follows: "[The] argument was made in the context of the first sentence of the first paragraph of item (k). With regard to interest rate support, Brazil would note that David J. Blair, in *Trade Negotiations in the OECD*…states at page 42: "There are a number of ways in which governments can give support to export financing. Official support may include insurance against commercial and political risk, guarantees of repayment, and insurance against cost-inflation and foreign exchange risk. Governments may also give financial support in the form of direct credits, refinancing and the *subsidisation of interest rates*…Brazil…[reiterates] that, in practice all financing with lenders inside Brazil has been done at LIBOR-plus or the CIRR rate" (emphasis in original).

[85]*See* para. 4.137.

[86]Brazil's Response to Questions From the Panel, No. 42.

[87]See para. 4.98 of this report.

1,000 basis points or more above what Bombardier and Canadian financial institutions must pay. PROEX offsets only 380 basis points of this premium. Brazil deduces that "[a]t current rates, approximately 670 basis points (1,050-380) [is] left for the private sector to absorb. Thus, in these circumstances, when the lender is inside Brazil, PROEX provides no material advantage and thus is not a prohibited export subsidy. Moreover, in the transactions when the lender was inside Brazil, the actual interest rate was always above LIBOR or the OECD rate in practice."

4.101 Further, according to Brazil, when the lender is a non-Brazilian financial institution outside of Brazil, it may be true that Brazil risk does not apply to that lender's cost of funds. But Brazil risk continues to apply to EMBRAER, and paragraph (k) of Annex I permits equalization payments that reflect the costs incurred by exporters such as EMBRAER as well as by financial institutions.[88] To establish how "Brazil risk" is present even in a transaction when the lender is outside of Brazil, Brazil submitted detailed, confidential business information to the Panel and its expert, Dr. Finan, gave a detailed presentation to the Panel.[89]

4.102 **Canada** challenges the accuracy of Dr. Finan's presentations[90] and submits that the argument by Brazil that PROEX subsidies are necessary to counter alleged developed country market advantages is baseless and unwarranted on the facts. Canada further submits that "even assuming that the "Brazil risk" argument is relevant, the argument must fail… If the [true] purpose of PROEX export subsidies were to reduce the "Brazil risk," they would be paid to the Brazilian lender that incurs the higher costs of borrowing, as indeed item (k) provides. Such payments would be made to a purchaser only in the unlikely circumstance that it has borrowed at a higher interest rate than that prevailing in the international market. Any such subsidy would directly reflect and offset such risk premium."

4.103 Canada "challenges vigorously" Brazil's assertion that it does not "seriously challenge" its argument that "when the lender is inside of Brazil, PROEX provides no material advantage and thus is not a prohibited export subsidy." Canada also denies that it accepts that "when the lender was inside Brazil, the actual interest rate was always above LIBOR or the OECD rate in practice." Canada submits that when assessing material advantage, "the question is not whether the lender faces a "Brazil risk" (or any other special cost) compared to other potential lenders. Rather, it is whether as a result of the PROEX export subsidy -- whatever the motivation -- the borrower obtains terms that are better than those available in the international financing market." Canada further submits that "in most, if not all, instances where financing is done in Brazil, it is done through…[Brazil's National Bank for Economic and Social Development] (BNDES). And when BNDES lends money to airlines, it does so at international commercial rates. Therefore, PROEX export subsidies, when applied to financing offered by BNDES, bring down the already commercial interest rate to one that is significantly below the international market." Canada provided evidence which, it submitted, offered proof that PROEX payments reduced the interest rate levels to be paid by a number of airlines significantly below "both LIBOR plus a credit risk premium and the OECD rates."[91]

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[88]Brazil's First Oral Statement, para. 38; Brazil's Second Written Submission, para. 52. Brazil argues that EMBRAER itself bears Brazil risk, and therefore that the costs it incurs in obtaining credits for its customers outside of Brazil, from lenders outside of Brazil, reflect Brazil risk. Brazil's Second Written Submission, para. 53. *See also* para. 4.47.

[89]*See* para. 4.117.

[90]*See* paras. 4.122 and 4.139.

[91]In particular, Canada noted that where Brazil has provided financing - for example, in the cases of Skywest and British Regional - the "post-equalisation" rate of interest offered by Brazil has been significantly below the OECD Consensus benchmark. Indeed, the effective interest rates offered by Brazil have been lower than the applicable yield on US Treasuries, themselves benchmarks for the OECD rate. Canada argued that the evidence it had adduced had not been contradicted or even questioned by Brazil. Further, the PROEX subsidy for aircraft is fixed at 3.8 per cent, regardless of the interest rate in the financing. To be operable in a manner consistent with the Consensus, the PROEX programme would have to provide for the

4.104 Canada submits that BNDES financing removes "Brazil risk" entirely. By doing so, it enhances the value of the PROEX export subsidy to the recipient. This is done in two steps. First, by lending at LIBOR-plus or the OECD rates, BNDES neutralises the financing question – that is, a purchaser does not have to look around for financing in the market. Indeed, the interest rates offered by BNDES-Exim, the new name for Brazil export financing programme, are set out in its web pages. It states that interest rates on its financing are equal to LIBOR plus 1 or 2 per cent, plus a risk premium. Canada noted in particular news reports indicating that BNDES financing had been announced for two transactions worth $3.2 billion in purchases by American Airlines. The amount financed by BNDES in one of the two transactions, $2.2 billion, was over five times the total amount of financing by the Export Development Corporation of Canada for Canadian regional jet delivered since 1995. Canada pointed out that American Airlines was not a small regional airline that was unable to obtain financing and that needed help from BNDES. The credit rating of AMR was, indeed, better than that of Brazil.

4.105 Canada further argues that BNDES financing completely undermines Brazil's argument that the "safe haven" of paragraph two of Item (k) is "of little or no practical value to developing countries." Brazil's export credit practices under BNDES – that is, excluding PROEX export subsidies – operate on precisely the same principles as those set out in this "safe haven" that Brazil alleges is of no use or value to developing countries because of the high cost of acquiring dollars. Canada states that if BNDES and PROEX simply reduced the interest rate offered to an airline to one that is above LIBOR or OECD rates, it would not have initiated the case against Brazil. BNDES lent to prospective purchasers at these international rates after which PROEX export subsidies were granted. In effect, Canada argues, PROEX has nothing to do with "Brazil risk."

4.106 Canada further submits that the second way in which BNDES absorbs "Brazil risk" is this: "By being the lender, BNDES absorbs the Brazil risk in the PROEX bonds -- that is, the risk that PROEX export subsidies would not be paid. Given the tendency of some lending institutions to discount the bonds for a lump sum because of Brazil risk, by being the lender, Brazil absorbs this risk as well. Airlines no longer have to advise their shareholders that there is a risk that subsidies would not be paid. As long as they are the ones owing money to Brazil – at subsidised rates, of course – there is no risk that the subsidies would not be paid."

4.107 Canada submits that the evidence it has adduced in this case proves that "PROEX export subsidies are made for the benefit of foreign purchasers that, for the most part, borrow funds from non-Brazilian institutions on the basis of their own credit risk." Canada submits that this fact has not been disputed by Brazil, as its largest customer, Continental Airlines, financed its initial purchase of 25 ERJ-145s from a lender outside of Brazil at rates that in no way reflected a Brazil risk premium. Canada asserts that the Brazilian argument that non-Brazilian purchasers of Brazilian goods suffer from financing costs solely on the basis of the Brazilian origin of the goods is without foundation. It "strains credulity to argue that non-Brazilian purchasers who obtain financing on their own credit, sometimes backed by guarantees offered by non-Brazilian suppliers, and often in non-Brazilian financing markets are somehow affected by a "Brazil risk"." Canada further submits that "financing offerings on the market for EMBRAER products have received ratings higher than that of Brazil's, based, as EMBRAER has noted, "not only on the liquidity of Continental Express [the purchasing airline] but also on the evaluation of EMBRAER and of the ERJ-145 aircraft." Canada also submits that a recent poll of financiers, lessors and airlines by the reputable industry journal *Airfinance Journal* noted a higher ranking for the ERJ-145 among investors than the Canadian Regional Jet. EMBRAER products were also considered to be easier

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adjustment of the subsidy in each transaction, so that it would compensate only for any excess in the financing rate over the OECD Consensus rate.

to finance than those of British Aerospace and ATR, both European manufacturers of long standing." Canada also notes that EMBRAER is supported by developed country suppliers in the production and development of its aircraft.

4.108 Canada argues that contrary to Brazil's assertions, PROEX export subsidies do indeed "secure a material advantage." This fact has been acknowledged by EMBRAER and Brazilian government officials and a number of airlines, which have publicly stated that they were influenced in their decision to purchase EMBRAER aircraft because of the financial incentive provided by PROEX. One such airline, according to Canada, is the American regional airline Comair, which "noted a 2 to 2.5 percentage point difference between commercial rates it pays on its purchase of Canadair Regional Jets and subsidised interest rates paid on the purchase of Brazilian regional aircraft." Other airlines include Skywest, also another American regional airline, which has acknowledged that "the rate of interest on long-term debt subject to Brazilian export subsidies was 4.0 per cent. At the same time, the unsubsidised rate of interest points other long-term debts ranged from 6.36 to 8.5 per cent - a difference of 2.36 to 4.5 percentage points in interest rates."

4.109 **Brazil** disputes Canada's claim that "the average rate of interest paid by Skywest was only *4 per cent*." It submits that Canada mischaracterizes the information on the record. Canada's information does not contain any evidence regarding the final financing of the Sky West sale. It contains no evidence of PROEX benefits of any kind, whether interest equalization or direct financing, having been made available. Brazil recalled that in its earlier submission and in the Finan Report, that PROEX direct financing has never been used for aircraft. In addition, Brazil referred to the full-length English translations of PROEX measures, specifically Law No. 8187, which established PROEX, and Provisional Measures 1629-13 and 1700-15, which replaced Law No. 8187, that it submitted to the Panel. For all three measures, Article 1 governs direct financing and Article 2 governs interest equalization. But Article 2 says that interest equalization is only available for operations "not included" (Law No. 8187) or "not covered" (Provisional Measures) by the direct financing scheme. As a result, Brazil argues that Article 2 of these measures precludes the possibility of both PROEX direct financing and interest equalization being made available in the same transaction. Brazil also disputes Canada's claim that Brazil provides both BNDES financing at roughly OECD rates, and then uses PROEX to bring the rate several points below both LIBOR and OECD rates. First, Brazil argues, Canada provides no evidence to support this contention, other than the statement of Sky West that "subsidy payments through the export support programme of the Federative Republic of Brazil" reduced the annual average interest rate on its long term debt to approximately 4.0 per cent. Brazil stated categorically that it does not make PROEX payments to Sky West or any other airline. Brazil argued that PROEX payments are made only to financial institutions. Brazil submitted that this does not mean that the Sky West statement necessarily is inaccurate, however; it simply means that, if accurate, it is not relevant to this dispute.[92]

4.110 Brazil recalled that PROEX was preceded by FINEX.[93] Brazil has no first-hand information concerning the statements made in the Sky West report concerning direct payment of subsidies to Sky West from Brazil. If Sky West in fact is receiving such payments, Brazil presumes they are from transactions involving FINEX.[94]

4.111 With regard to BNDES, Brazil states BNDES is a bank, which operates on normal banking principles, and is not within the terms of reference of this dispute.[95]

[92]Brazil's Comments on Additional Information Submitted by Canada, paras. 3-12.
[93]*See* para. 4.48 of this report.
[94]*Supra* note 93 at para. 14.
[95]*Ibid* at para. 16.

4.112 Brazil argues in paragraph 51 of its Second Written Submission, when the lender was inside Brazil, the actual interest rate was always above LIBOR or the OECD rate in practice.[96] According to Brazil, the term "in practice" refers to the fact that the Brazil sovereign risk premium, calculated as the spread over the US 10-year Treasury Bond, has never been fully compensated by the maximum allowable spread equalized under PROEX. Figures 2.3 and 2.4 of the Finan Report clearly demonstrate this fact, according to Brazil. Therefore, private lenders inside Brazil would not be able to fully offset their cost of capital, since they cannot obtain capital at costs lower than the Brazilian government. "In practice," Brazilian authorities supervise the relationship between the risk spread and the equalization margins provided by PROEX, to ensure that PROEX payments do not overcompensate the risk spread. Brazil argues that Canada never disputed this rationale during the proceedings of the Panel.[97]

4.113 Brazil argues that Canada's mistake is in assuming that PROEX equalization payments are made to the manufacturer or to the buyer of the aircraft, who would get subsidies on top of international commercial rates. But all payments from the PROEX equalization programme are made to the financing institution, including BNDES, so that it may offset part of the costs it incurs in obtaining the funds that will be lent at internationally competitive rates.[98] Further, Brazil does not acknowledge that any sales of EMBRAER regional aircraft supported by PROEX interest rate equalization were "made at an interest rate below that of the CIRR rate (taking into account interest rate equalization)," as Canada alleges.[99] Brazil argues that when aircraft purchasers are financed by Brazilian banks as the lender, PROEX only offsets the Brazil risk in the cost of funds for the Brazilian banks. When the aircraft is purchased under a lease structure and a non-Brazilian lender provides the debt, the relevant measure for the purpose of determining material advantage is EMBRAER's costs related to the obtaining of the credits. As illustrated by Dr. Finan's confidential business information presentation at the Second Panel meeting, these Brazil risk-related transaction costs exceed the PROEX equalization payment. Also, when the lender is outside of Brazil, totally apart from Brazil risk, Brazil argues that EMBRAER is adversely affected by the subsidies provided by Canada to its exporter (without regard to whether or not those subsidies are consistent with Canada's WTO obligations).[100]

4.114 Brazil alleges that Canada has misinterpreted its submissions regarding the purpose of PROEX and the way the programme is administered. Brazil argues that it has never claimed "market failure" as the justification for PROEX. PROEX, it submits, is justified by the objective facts of the market, as has been demonstrated in the Finan report and elaborated on during the Panel meetings. Figure 2.3 of the Finan Report depicted Brazil risk as measured by the spread between Brazilian and US bonds. In the aircraft sector itself, there is no market "failure" as such; rather, it is appropriate to allege market "fixing" by Canada. In 1996, EMBRAER brought its ERJ-145 into a market that, for the previous four years, had been the exclusive domain of Canada's Bombardier. The characteristics of this market were set by numerous Canadian measures – the benefits conferred by Canada's Export Development Corporation and the Canada Account; the development and production subsidies made by Technology Partnerships Canada and its predecessor programmes; the measures implemented by Ontario and Québec. The 15 or more year financing term was but one characteristic of this market. "Market failure" is not the term for this set of circumstances; "market rigging" is more appropriate. Brazil could not match the Canadian benefits dollar for dollar. No developing country could. PROEX was simply an effort to level somewhat the tilted playing field. Brazil notes, and it was uncontested by Canada, that Mr. Ian Gillespie, President

[96]Brazil's Response to Questions From the Panel, No. 34, subpart 1.
[97]*Ibid*.
[98]*Ibid*.
[99]Brazil's Response to Questions From the Panel, No. 34, subpart 2.
[100]*Ibid*; *see* para. 4.117.

of Canada's Export Development Corporation, told a committee of Canada's Parliament that, "The goal for Canada is to make sure that we have a competitive advantage for Canadian exporters, not just a level playing field." [101]

4.115 Brazil argues that Canada is wrong in its view that it is not the sovereign risk of Brazil that is important, but the sovereign risk of the country in which the aircraft is operated. Brazil submits that while the sovereign risk of the country of operation may be relevant to a lender, it is a totally different risk from the sovereign risk that raises the costs of funds in the country of export. Thus, while "Brazil risk" may not be applicable when the lender is outside of Brazil, it would still continue to apply to EMBRAER. PROEX offsets part of the added cost in obtaining credits that financial institutions and exporters experience as a result of Brazil risk, not the risk of the country of operation.

4.116 Brazil submits that the Canadian argument that rates charged to foreign purchasers of Brazilian products do not reflect "Brazil risk" is wrong and misunderstands the nature of "Brazil risk" and how PROEX operates to level the playing field. It further submits that Canada misunderstood the COEX transaction, which it has referred to many times. Brazil stated that the COEX transaction was unique not only because it involved a non-Brazilian lender and a non-Brazilian customer, but also because it was the first transaction and is the largest transaction, to date. To establish how "Brazil risk" is present even in a transaction when the lender is outside of Brazil, Brazil submitted detailed, confidential business information to the Panel and its expert, Dr. Finan, gave a detailed presentation to the Panel, subject to its working procedures. The Panel and Canada had an opportunity to submit questions regarding the presentation.[102]

4.117 In his statement to the Panel during the second meeting with the Parties, Dr. Finan documented the additional costs to EMBRAER due to "Brazil risk" of obtaining credits in a transaction where both the aircraft purchaser and the financing sources were located outside Brazil. He specifically provided documentation concerning the facts and circumstances of the COEX transaction. Since the details of the transactions were business confidential, Brazil provided its information to the Panel in the following business confidential submissions: (1) "Oral Statement of Dr. William F. Finan on Behalf of Brazil," a written submission to the Panel provided at the second panel meeting; (2) "Evaluating Brazil Risk in the Continental Express Transaction," an oral submission and copies of graphics provided to the Panel at the second panel meeting; and (3) "Supplemental Submission of the Government of Brazil Response to the Panel's Request for Sources of Information for Dr. William F. Finan's Presentation 'Evaluating Brazil Risk in the Continental Express Transaction" submitted 21 December 1998. Brazil also provided business confidential information in follow-up questions from both Canada and the Panel regarding the COEX presentation.

4.118 Dr. Finan reported that on 4 July 1996, COEX entered into an agreement that covered the purchase of up to 200 ERJ-145's. The price of each aircraft, net of the PROEX benefit, is financed via a mix of equity and debt, with 20 per cent equity provided by third party providers and 80 per cent provided by debt in the form of Enhanced Equipment Trust Certificates ("EETC's"). But because EMBRAER is a developing country-based aircraft manufacturer, Brazil submits that providers of equity to the COEX leveraged lease arrangement would not accept EMBRAER's guarantee of the residual value of the aircraft (an RVG), which is critical to competitively financing an aircraft. Brazil also submits that EMBRAER

[101]Brazil's First Oral Statement, para. 41.

[102]The information that Brazil submitted to the Panel regarding the COEX transaction contained confidential business information, so pursuant to the Rules of Procedure which were adopted by the Panel, not all the relevant information was disclosed; *see* para. 4.117 of this report.

could not obtain equity financing on its own and that the reason for the equity holder's refusal to accept an RVG from EMBRAER was "Brazil risk".

4.119 Dr. Finan argued that EMBRAER company risk was not the reason equity holders refused to accept EMBRAER's RVG. Dr. Finan submitted that the Standard and Poor's ("S&P's") ratings of EETC's also support this conclusion. Dr. Finan noted that S&P grants the highest rated class of certificates, an A+ rating, classifying the certificates are of investment grade quality. Dr. Finan argued that although holders of EETC's bear risks that include both aircraft and manufacturer risks, the EMBRAER-related company-related risks are not considered to be sufficiently significant to preclude S&P from assigning an investment grade rating to the highest rated tranche of COEX EETC's. As a result, Dr. Finan concluded that neither EMBRAER company risk nor risk associated with EMBRAER aircraft design and operating performance is the basis for the equity providers' refusal to accept an EMBRAER RVG.

4.120 Dr. Finan concluded that because of "Brazil risk," "EMBRAER was required to enter into a complex, expensive-to-maintain financing structure that brought in a third party…These added costs were well in excess of the typical transaction costs associated with setting up and maintaining a leveraged lease financing structure for an aircraft." The "Brazil-related costs in the COEX deal [arose] from: (i) added transaction costs borne by EMBRAER in having to support an unusually complex financing structure that reduced Brazil risk exposure for the equity holders, (2) special payments to the third party to obtain the 20 per cent equity financing, and (3) a special escrow account."

4.121 Brazil further submits that, contrary to Canadian assertions, most of the transactions involved a lender inside Brazil.[103]

4.122 **Canada** contests the evidence presented by Dr. Finan in connection with the COEX transaction on three grounds. First, it argues that the cost "allegedly incurred by EMBRAER was not reflected in a higher price to COEX that was then reduced with the aid of subsidies. Rather, PROEX export subsidies provided a discount to COEX on an already discounted price…resulting in a final cost to COEX [which was substantially lower than the original contract price]." Second, Canada points out that "[T]he nature of the costs incurred by EMBRAER in arranging financing for the COEX deal do not result from "Brazil risk": they are costs that are normally incurred by manufacturers in putting together financing packages in similar situations. Finally, Canada argues that "the methodology [followed] in assessing the value of the costs allegedly incurred by EMBRAER is seriously flawed" and notes that it is not in any way clear why the compensation allegedly made necessary by "Brazil risk" should not be limited to the actual expense rather than the opportunity cost.

4. Interpretation of the phrase "in the field of export credit terms" in item (k)

4.123 **Brazil** argues that PROEX subsidies do not secure a material advantage "in the field of export credit terms", because under the terms of item (k) of the Illustrative List, PROEX subsidies should be compared with the "numerous Canadian subsidies that translate into export credit terms." Brazil submits that the phrase "field of export credit terms" should encompass these subsidies which are provided by the Canadian government to Bombardier, its competitor in the regional civil aircraft market.

4.124 **Brazil** refers to the First Written Submission of Canada to the Panel and endorses the statement made by it that, in the regional aircraft industry, the phrase "field of export credit terms" *includes* transaction costs and interest costs. Brazil argues, however, that the phrase encompasses far more than

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[103] *See* para. 4.46 of this report.

that. It submits that Canada has admitted that the phrase encompasses "financing terms for export transactions," which is broader than the narrower scope of transaction and interest costs argument adopted by Canada later in the dispute. Brazil noted[104] that in Canada's first written submission to the Panel, Canada stated at paragraph 22 that aircraft are capital assets and "few carriers have the financial capacity to make outright purchases of such capital assets." Canada goes on to explain, at paragraph 23, that anything that affects the financing cost of an aircraft should be considered an export credit in the regional aircraft market. Brazil noted that Canada stated that:

> [a]cquisition costs, especially financing programmes, are the largest non-operating performance related selling point a manufacturer uses in marketing its aircraft. Indeed, aircraft selection is often driven by the lowest monthly financing cost, as regional airlines are motivated to purchase aircraft on the basis of profitability of given routes: the lower the financing cost, the greater the number of routes that become profitable. The financing structure of a transaction is therefore one of the most important elements in determining whether a particular aircraft would be profitable for an airline.

Brazil noted its agreement with these statements.[105]

4.125 Brazil argues that it is necessary for EMBRAER to offer a competitive financial package to its customers as a direct result of the practices adopted by Canada and the OECD Members who are active in the commercial aircraft industry. Brazil submits that they have adopted the practice of offering subsidized financing to the airline customers of their aircraft manufacturers.[106] Brazil argues that Canada tilts the playing field in its favor by influencing financing for aircraft. Brazil submits that aircraft financing cost is composed of three essential elements: the rate of interest, the duration of the loan, and the aircraft price. All three affect the crucial monthly cost of the airplane to the airline. Governments may lower this payment by measures that affect any of these three broad elements. Brazil claims that Canada's programmes affect all of these in a way that tilts the playing field in its favor.[107] In Brazil's view, Canada's position in its first written submission confirms the understanding that both Canada and Brazil agreed that, in the field of regional aircraft, the "field of export credit terms" encompasses far more than transaction and interest costs. Brazil submits that Canada's claim that, as applied to regional aircraft, the phrase "field of export credit terms" does not encompass all of the factors that affect the crucial monthly aircraft payment, including price, is inconsistent with the position it took in its first submission. It is also inconsistent with its attack on PROEX itself, for Brazil argues that PROEX is an "export credit term" as that phrase is used in the SCM Agreement.[108] Brazil argues that the practice of governments of paying all or part of the costs incurred by exporters or financial institutions in obtaining credits is within the "export credit terms" portion of Annex I of the Agreement – item (k). PROEX represents such a practice by Brazil.[109] Further, Brazil submitted to the Panel a study prepared by the accounting firm of Ernst & Young that was given to Brazil by Canada in the course of previous negotiations regarding a possible bilateral agreement. According to Brazil, Canada was of the view that the Ernst & Young study was an authoritative analysis of the financial impact PROEX and represented it to Brazil as such. The Ernst & Young study is discussed in the Finan Report and analyzes PROEX in terms of its price impact on the aircraft, noting that the benefit will vary from one transaction to another since the aircraft price,

[104] Brazil's First Oral Statement, paras. 42-45; Brazil's Response Questions From the Panel, No. 9.
[105] Brazil's First Oral Statement, paras. 42-45.
[106] Brazil's Second Written Submission, para. 54.
[107] Brazil's First Oral Statement, para. 46.
[108] Brazil's Second Written Submission, para. 39.
[109] *Ibid* at para. 40.

financing terms, percentage of equalization and interest rate may vary.[110] Brazil submits that the point Ernst & Young made, and the point with which Brazil agrees, is that in the regional aircraft industry, any factor that affects monthly cost affects financing. In essence, in order to establish the typical aircraft financing conditions it is necessary to include the aircraft price.[111] An analysis that ignores this fact invites Members to "fine-tune" their programmes so that they comply with the provisions of the Agreement narrowly-construed, not in their context, and not in light of the Agreement's object and purpose.[112] Brazil agrees both with Canada's view and with Ernst and Young's view that, in so far as regional aircraft are concerned, anything that affects the crucial monthly cost of the airplane to the airline is an export credit term. As explained at pages 1.4 to 1.6 of the Finan Report, and detailed in Table 1.1 at page 1.7 of the report, Brazil again argued that the crucial monthly financing cost of the airplane is composed of three essential elements: the rate of interest, the duration of the loan, and the price. In Brazil's view, all are properly export credit terms for regional aircraft since all refer to the financing terms for export transactions for this particular market.[113]

4.126 In response to a question from the panel,[114] Brazil submits that the Parties appear to agree that, in so far as regional aircraft are concerned, the particular market characteristics that prevail necessitates a broad definition of "export credit terms." The two most important characteristics are that aircraft are (1) a capital good and (2) the exporter is expected to provide a financing package to the buyer. Under the facts and circumstances present in this dispute, Brazil argued that price must be included as an element of export credit terms since only by including it can a comparison be made of the benefit the aircraft purchaser receives from Canada's numerous subsidy programmes that affect buyer's credits versus the benefit received from Brazil's single PROEX programme.[115]

4.127 **Canada** does not agree with the definition of the phrase "in the field of export credit terms" put forward by the Brazilian government. Canada submits that when the phrase is interpreted using principles of treaty interpretation in customary international law, it would become clear that it refers to interest rates and other transaction costs in an export financing transaction. The phrase does not, therefore, have the all-encompassing interpretation given to it by Brazil.

4.128 Canada submits that in applying the principles of the Vienna Convention, the first step is to determine the ordinary meaning of a provision. The phrase "export credit terms " means "the financing terms for export transactions." Financing terms, in turn, refer to transaction costs (fees, etc.) and interest costs associated with financing a transaction. The context of the phrase supports this ordinary meaning. The first paragraph of item (k) is concerned with the grant by governments of export credits "at rates below those which they actually have to pay for the funds so employed" and the payment of all or part of the costs of obtaining funds incurred by exporters or financial institutions. The second paragraph refers to Members' applying the interest rate provisions of the relevant undertaking, which is the OECD consensus. The context of the phrase "export credit terms" does not, therefore, support Brazil's assertion that the phrase "should include either the "price" of the aircraft or alleged subsidies for comparative purposes. The phrase refers to "interest rates and other costs specifically related to export financing transactions."

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[110] *Ibid* at para. 41.
[111] Response to Questions From the Panel, No. 9.
[112] *Supra* note 109 at para. 42.
[113] *Supra* note 112.
[114] The Panel's question 9 asked Brazil to: "Please provide further explanation why, in the view of Brazil, 'the field of export credits' relates to all subsidies provided by a Member, and is not limited to terms directly related to export credits themselves."
[115] *Supra* note 112.

4.129 Canada further submits that the phrase refers to an objective standard against which "material advantage" should be measured, rather than "a case-driven and indeterminate standard." In the context of item (k), it is clear that the phrase "field of export credit terms" "simply means…the international market for financing." Brazil's argument that comparison should be made with Canadian government subsidies to Bombardier is incorrect and ignores the ordinary meaning of the relevant words. The relevant dictionary definitions of "field" are "all the competitors in a race or all except those specified" or "an area of operation or activity." Field, therefore, does not mean one player out of many. Field of export credit terms does not refer to the activities of one country alone. It does not mean "numerous…subsidies" of one country with respect to one company alone.

4.130 Canada argues that in context, the word "field" refers to an "area" of a certain practice, or "all" participants who engage in that practice. The practice is "export credit terms," or export financing. In business terms, this reference to a general practice would be called "the market." The appropriate benchmark therefore is the interest rates and other transaction costs offered in the international financing market. The phrase "export credit terms" refers to interest rates and other transaction costs related to export financing. It does not include research and development contributions. Neither does it include the privatisation of state-owned enterprises, nor numerous other subsidies, as contended by Brazil and certainly not the price of the goods being financed.

(a) Canada's alleged subsidies to Bombardier

4.131 **Brazil** argues that the determination of whether PROEX is used to secure a material advantage in the field of export credit terms for regional aircraft should be made by comparing the total package of benefits offered by Canada. This is because, Brazil argues in its First Written Submission,[116] producers of aircraft sell more than aircraft; they also "sell" financing. The total financing package affects the total cost of the aircraft. This is crucial to the customers, the airlines, which look essentially to the total monthly cost to finance an aircraft for a given route. From this perspective, Brazil submits that every element that affects that monthly payment is significant.[117]

4.132 Brazil refers to its interpretation of the phrase "in the field of export credit terms" and states that such a comparison would reveal that it is Canadian subsidies to Bombardier which secure a material advantage in the field of export credit terms. Brazil submits in its First Written Submission[118] that Canada is determined to feed "the seemingly endless appetite of Canadian exporters for financial support."[119] Canada has the stated goal of moving from sixth to fourth internationally in aerospace ahead of Germany and Japan.[120] As documented by the Finan Report, Brazil argues that Canada has granted an array of subsidies to its regional aircraft producer, Bombardier, in an effort to succeed.[121] This array of subsidies, which Brazil argues far exceeds anything Brazil or other developing countries could afford, is a reality which Brazil submits translates into advantageous export credit terms for Canada's aircraft manufacturer, and with which Brazil must contend if its producer is to have any chance in the market. Brazil argues in its First Written Submission that it is unable to match Canada's subsidies in kind. Developing countries, with their limited resources, Brazil submits, are in no position to meet the subsidy offerings of developed countries.[122]

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[116]Brazil's First Written Submission, para. 6.7.
[117]*See* paras. 4.124 - 4.126.
[118]Brazil's First Written Submission, para. 4.10.
[119]Export Development Corporation, 1995 *Chairman and President's Message*, p. 4 (Exhibit Bra-5).
[120]Industry Canada, News Release, December 17, 1996 (Exhibit Bra-6). *See also* TPC Annual Report 1996-1997, p.5 (Exhibit Bra-7).
[121]Finan Report, Part 3.
[122]Brazil's First Written Submission, para. 6.9.

4.133 Brazil submits that it is not requesting the Panel to make any ruling regarding the consistency or inconsistency of Canada's subsidies with its obligations under the SCM Agreement. What is relevant to the issue before this Panel is the very existence of Canada's subsidies, not their consistency with the Agreement. As argued by Brazil in its First Written Submission,[123] this is because these subsidies have a direct bearing on the question of whether PROEX provides a material advantage in the field of export credit terms regardless of whether they are in conformity with Canada's obligations. For example, one Member may provide support which conforms to the interest rates provisions of the Arrangement on Guidelines for Officially Supported Export Credits of the OECD, which is referenced by Annex I(k) of the SCM Agreement – "an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979." Another Member may provide support in a different form. To determine whether the latter provides a material advantage, it is necessary to examine the former, regardless of the former's conformity to the terms of the SCM Agreement.

4.134 The magnitude of Canada's subsidies, and the extent to which it is willing to open its treasury to achieve the goal of surpassing Germany and Japan in aerospace, can be appreciated by the remarks of M. Henri Souquieres, Vice President of the Export Development Corporation, Canada's export credit agency. As documented in the Finan Report, M. Souquieres stated in 1996 that the EDC alone funded more than 25 per cent of Canada's total aerospace development in the previous three years, with the transportation sector taking more than $1.7 billion in 1995. He states that support for Bombardier's 50-seat Canadair regional jet accounted for 62 per cent of this Can$1.7 billion total, or Can$1.0 billion, or US$770 million. This 1995 support works out to US$18.3 million per regional jet delivered in 1995. This is virtually 100 per cent of the List price of the airplane. To be sure, 1995 was the year before EMBRAER's 1996 entry into the market, but support of this magnitude given to Bombardier in 1995 certainly contributed significantly to the market conditions in which EMBRAER had to compete in 1996 and thereafter.

4.135 Brazil submits that among the subsidies given to the regional aircraft industry in Canada by the Government of Canada and two of its provinces, Québec and Ontario include the following: (i) Export Development Corporation equity investments, loan guarantees, insurance, and direct financing; (ii) Canada Account, a special fund for projects that do not meet even the relaxed criteria for EDC support; (iii) Technology Partnerships Canada support for the development costs of Bombardier's regional aircraft; (iv) Technology Partnerships Canada support for Bombardier's suppliers; (v) Ontario Aerospace Corporation dealings with Bombardier on less than commercial terms; and (vi) Programs of the Government of Québec. Brazil noted as an illustration of Canada's programmes that Bombardier is now producing a 70 seat regional jet, with the aid of a Technology Partnerships Canada "investment" of $87 million. In its written submission Brazil has explained why this "investment" is little more than an outright gift.[124] Brazil reported that EMBRAER has considered producing a 70 seat aircraft, but has not yet been able to do so. Brazil notes that EMBRAER has cited development costs as the obstacle to producing the larger airplane and has opted, instead, for a 35 seat aircraft, which permits it to use much of the technology from the 50-seat ERJ-145.[125] Brazil acknowledges that whether EMBRAER would have produced a 70-seat regional jet had it received an $87-million "investment" from the Government of Brazil is uncertain. But Brazil argues that there is no question that such a contribution would have made an enormous difference. If EMBRAER eventually launches such an airplane, its price will have to reflect 100 per cent of the development costs. There is no "Technology Partnerships Brazil" to pick up the product development bill and throw millions of dollars EMBRAER's way.[126] The price of the

[123] *Ibid* at para. 4.11.
[124] Brazil's First Oral Statement, para. 54.
[125] *Ibid* at para. 55.
[126] *Ibid* at para. 56.

Bombardier jet, in contrast, will not have to reflect 100 per cent of its development costs. At a minimum it will not have to repay the $87 million "investment" from Technology Partnerships Canada.[127] As a consequence, all other things being equal, Brazil submits that the selling price of a Bombardier aircraft that benefits from the $87 million subsidy will be lower than the selling price of an EMBRAER aircraft that does not benefit from such a subsidy. This lower selling price immediately translates into the financing structure of a transaction and is, as Brazil notes Canada says at paragraph 23 of its first written submission, "one of the most important elements in determining whether a particular aircraft would be profitable for an airline." Brazil argues that all of Canada's programmes contribute to lowering the monthly financing cost of regional aircraft.[128]

4.136 Brazil submits that the cost of Canadian subsidies is beyond the reach of Brazil or any developing country. Because of the general lack of transparency of Canada's programmes, it was difficult to estimate the contribution from all of them. For those where subsidies could be calculated, however, the aggregate benefits ranged from US$1.883 billion to US$2.446 billion.[129] This undoubtedly is a conservative figure given M. Souquieres' report of Can$1.0 billion of support from one agency - EDC -- in one year - 1995 - alone.[130]

4.137 Brazil refers to its "Brazilian risk" argument and states that in the case of loan guarantees, the credit rating of the country guaranteeing the loan is very important as it would affect the terms of the loan granted by the lender. Brazil submits, in paragraph 6.10 of its First Written Submission, that the Finan Report makes clear why developing countries, such as Brazil, are unable to match the subsidy programmes of developed countries in kind.[131] In the case of loan guarantees, for example, Brazil argues it is clearly a matter of country risk. It notes in that connection that "[a] guarantee on a loan to a financially risky regional airline guaranteed by Canada offers the lender the security of Canada's sovereign risk; the same loan guaranteed by Brazil offers a sovereign risk that today is more than 1,000 basis points or 10 percentage points above Canada's." Brazil submits that in evaluating the question of material advantage, it is essential for the Panel to be mindful of the difficulties developing countries inescapably face in this area. Brazil also argues that, without question, Bombardier enjoys a decided advantage over EMBRAER in having better access to financial capital on more favorable terms. This is simply a manifestation of Canada's advantage as a developed country, in having a stronger capital market that does not bear a significant spread for sovereign (or country) risk. Relative to Brazil, and any other developing country, better access to cheaper financial capital simply gets factored into the overall advantage of Canada as a location for aerospace manufacturing. The relevant issue for the dispute at hand is that the Brazil risk premium precludes the Government of Brazil from providing certain types of export credits to aircraft purchasers.[132]

4.138 **Canada** disputes the assertion of Brazil that PROEX is the only Brazilian programme from which EMBRAER benefits. It states that EMBRAER has been the beneficiary of many different types of support since its privatisation in 1994. On its own publicly accessible website, EMBRAER acknowledges that: "As a Brazilian corporation which manufactures and exports capital goods, EMBRAER has the support of …FINAMEX, FINAME, BNDES and PROEX" managed by "Banco do Brasil S.A." These Brazilian Government agencies play a very important role in boosting our exports." In the light of all these subsidy programmes, Canada submits that Brazil's repeated assertions about its inability to finance EMBRAER's sales are difficult to believe. In 1997, EMBRAER publicly stated in an

[127] *Ibid* at para. 57.
[128] *Ibid* at para. 58.
[129] Finan Report, p. 3.8.
[130] *Ibid* at p. 1.1.
[131] *Ibid* at pp. 1.12-1.14.
[132] *Ibid* at p. 3.20.

Offering Circular aimed at attracting investors that it expected to export ERJ-145 totalling US$3.3 billion with support from PROEX. It also stated that "[t]he Brazilian government has also been an important source of export financing for…[its] customers." Canada notes that the first instalment of this support was in 1997 when BNDES advanced a US$1 billion loan to American Airlines to finance the sale of 42 ERJ-145s.

4.139 Canada notes that the credibility of the Finan Report is compromised by methodological errors and unsubstantiated allegations. In particular, it does not distinguish between alleged benefits that have already been received and those that hypothetically may be received in the future, the timeframes for evaluating alleged subsidies appear to have been chosen arbitrarily and the report purports to show that the subsidy value of a repayable loan or contribution is greater than the subsidy value of a grant of the same amount. Canada also notes that according to Brazil's calculations, $3.4 to $4.7 million of Canada's alleged subsidies of $4.4 to $6 million come from the Export Development Corporation (EDC). The difficulty with the analysis is that in many of the transactions involving competition between Bombardier and EMBRAER, the EDC was not even involved in offering financing because of the impeccable credit rating of those airlines including Luxair, British Regional Airlines and British Midlands. Canada submits that according to the calculation in the Finan Report then "all other alleged subsidies in Canada's alleged "vast array" amounted to only $1 million to $1.4 million, as compared with the $2.45 million of subsidies paid by Brazil through PROEX. Thus, even under the standard proposed by Brazil, PROEX secures a material advantage in the field of export credit terms.

4.140 Canada argues that PROEX subsidies are paid also when Bombardier is not involved in competition with EMBRAER for a contract. Thus, Brazil's argument that it provides subsidies to match the subsidies that Bombardier receives from the Canadian government is without merit. Canada submits that the competition between Fairchild Dornier and EMBRAER is interesting, as it demonstrates that Brazil provides PROEX subsidies, even in cases where its competitor has not even been accused of benefiting from subsidies.

4.141 Canada contends the Brazilian argument that EMBRAER suffers from market disadvantages vis-à-vis Bombardier because EMBRAER is a developing country manufacturer of regional jet aircraft is patently false. EMBRAER, it submits, is a well-established regional aircraft manufacturer, having sold commercial aircraft around the world for over two decades. EMBRAER is, in fact, larger than the United States - German aircraft manufacturer Fairchild Dornier, one of its developed country competitors. EMBRAER has survived when Saab and Fokker, two major developed country turboprop manufacturers, have failed. If EMBRAER were facing difficulties, it would not have announced its intention to increase production to 12 regional jets a month, enough to satisfy the world-wide total demand in the regional aircraft market in the coming years.

4.142 Canada submits that EMBRAER's receives extensive support from its developed country suppliers and as such it cannot claim to be an isolated developing country manufacturer. Canada relies on the following observation in a study prepared in 1997 by the investment bankers Deutsche Morgan Grenfell:

> "Under EMBRAER's risk-sharing package for the EMB-145, the company is effectively financed by its suppliers: under the terms of the agreement, the company only pays suppliers for components for the aircraft after delivery to the client and the payment for the aircraft are received."

Canada further submits that more than one third (US$130 million) of the costs of development of the ERJ-145 (US$350 million) were borne by these "partner-suppliers." EMBRAER's suppliers also provide

guarantees to improve the financing terms offered to EMBRAER's customers. Brazil's assertion about EMBRAER is not, therefore, correct.

4.143 Canada argues that market disadvantages between private sector competitors is not a justifiable ground for export subsidisation. Carried to its logical conclusion, Brazil's interpretation of item (k) of the Illustrative List would permit WTO Members - including developed countries - to provide subsidies to compensate for their own perceived market disadvantages.

4.144 **Brazil** disputes that PROEX subsidies provide US$2.45 million. As documented in the Finan Report, Brazil used the number for comparison purposes only against the US$4.4 million to $6.0 million conservative estimate it prepared regarding Canadian subsidies. The US$2.45 million figure stated in the Ernst & Young Report had been previously presented to Brazil as authoritative of Canada's view regarding PROEX.[133]

4.145 Brazil disputes Canada's implication that PROEX is made available even when Bombardier is not involved. Canada cites Fairchild-Dornier, a German-US manufacturer of regional aircraft.[134] Brazil stated that when Canada refers to Fairchild-Dornier's "small size and uncertain credit," the Panel should understand that Fairchild-Dornier is a division of the giant US conglomerate, Fairchild Aerospace. It has already launched a new family of jet liners, including a 70 seat jet, to be followed by 50 and 90 seat versions. Brazil notes that EMBRAER, for lack of funds, had to back away from the 70 seat market, and concentrate on the 35 seat market as an alternative to the 50 seat jet.[135] Second, Canada offers the statements of officials of Fairchild-Dornier as proof that PROEX secures a material advantage in the 35 seat segment of the market. These statements allegedly reflect what airline customers claim EMBRAER was saying to them – the customers. Brazil argues that this information constitutes double, if not triple, hearsay. Brazil notes that an airline buyer, negotiating with two manufacturers, has an incentive to tell each of the manufacturers that its offer is not as good as the other. The potential for exaggeration, if not fabrication, in such a situation is obvious. But regardless of the veracity of the statements of the officials of Fairchild-Dornier, the fact is that they do not speak for Brazil and PROEX and, for that matter, neither do the officials of EMBRAER. Brazil is not responsible for what an EMBRAER salesman may tell an airline. Much less is it responsible for what an airline may tell another company that EMBRAER may or may not have said. Brazil is responsible for what it does, and that is simply to offset part of the cost of obtaining funds, incurred by financial institutions and exporters, in a manner that does not secure a material advantage in the field of export credit terms.[136]

4.146 In addition, Brazil argues that Brazil risk continues to apply to EMBRAER when the lender is a non-Brazilian financial institution, even though Brazil risk does not apply to the lender's cost of funds. In response to a question from the panel,[137] Brazil notes that the statement does not refer to the higher cost of capital raised by EMBRAER for use in development and production of civil aircraft, for example. Brazil acknowledges that EMBRAER faces higher capital costs than its developed country competitors and that paragraph (k) does not permit subsidies to offset such costs. However, Brazil argues that paragraph (k) does permit subsidies to offset "all or part of the costs incurred by exporters or financial institutions in obtaining credits." Since this is the function of PROEX, Brazil argues that PROEX is consistent with the SCM Agreement.[138]

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[133] *See* para. 4.125.
[134] Brazil's Second Oral Statement, para. 63.
[135] Brazil's Second Oral Statement, para. 64.
[136] Brazil's Second Oral Statement, paras. 65-67.
[137] Brazil's Response to Questions From the Panel, No. 11.
[138] Brazil's Response to Questions From the Panel, No. 11.

D. ARGUMENTS UNDER ARTICLE 27 OF THE SCM AGREEMENT

4.147 **Brazil** argues that even if PROEX payments are found to be prohibited export subsidies, Article 27 permits developing countries such as Brazil to maintain export subsidies for a period of eight years from the date of entry into force of the WTO Agreement. Brazil submits that the only obligation it has to satisfy is that it has not increased the level of its export subsidies since 1991, the year PROEX was enacted and implemented. It introduced evidence which, according to it, demonstrated that it has not increased the level of its export subsidies and, as such, was entitled to have recourse to Article 27. **Canada** does not contest that Brazil is a developing country entitled to invoke Article 27 as an affirmative defence. It argues, however, that since Article 27 is an exception to Article 3, Brazil has to adduce evidence to prove that it has complied with the conditions set out by Article 27.4. It argues that contrary to Brazil's assertion that it has to satisfy only one requirement, there are two other conditions it has to satisfy, namely (i) that it must *phase out* its export subsidies within eight years after the entry into force of the WTO Agreement, that is by 31 December 2002; (ii) that it must phase out its export subsidies in a shorter period than eight years, if the use of such export subsidies are inconsistent with its development needs. Canada argues that Brazil has not complied with the conditions set forth in Article 27.4 and, as such, it cannot escape the prohibition against export subsidies in Article 3.1(a) of the SCM Agreement.

1. Whether Article 27 is *Lex Specialis* to Article 3 of the SCM Agreement

4.148 **Brazil** submits that Article 27 is *lex specialis* to Article 3 in that it provides special rules with regard to the export subsidy programmes of developing countries. Consequently, as to developing countries, it displaces Article 3, which is *lex generalis*. Brazil further submits that because Article 27 is *lex specialis* to Article 3, developing countries are not expected to comply with the provisions of the latter: As far as export subsidies are concerned, Article 27 provides the sole standard applicable to developing countries. Brazil further argues that since Canada has not alleged a breach of Article 27, its complaint must be rejected by the Panel, as Brazil cannot be held to be in breach of Article 3.

4.149 **Canada** disagrees with Brazil that Article 27 is *lex specialis* to Article 3. It argues that *lex specialis* is invoked where a choice has to be made as between conflicting treaty obligations. The value of this maxim is questionable even in the context of treaties in conflict; its elevation to a *principle of interpretation* in respect of articles within the same treaty should be viewed with scepticism. Canada submits that at issue is the relationship between general provisions in a treaty and provisions for special application, or exceptions to such general provisions. As there is no conflict between Articles 3 and 27, in the sense that adherence to one will lead to a violation of the other, this maxim is entirely inapplicable in this case. Canada recalls that Article 27.2 of the SCM Agreement provides, in relevant part:

> The prohibition of paragraph 1(a) of Article 3 shall not apply to: … (b) other developing country Members for a period of eight years from the date of entry into force of the WTO Agreement, subject to compliance with the provisions in paragraph 4.

Canada submits that by the very terms of Article 27.2, Article 3 shall not apply to Brazil for a period of eight years from the date of entry into force of the WTO Agreement, subject to compliance with the provisions in paragraph 4. By necessary implication, and contrary to Brazil's interpretation, if Brazil does not comply with Article 27.4, then Article 3 shall apply to Brazil. Thus, it is certainly possible for developing countries, such as Brazil, "to act in a manner inconsistent with Article 3." Canada asserts that any other interpretation would be contrary to the principle of effectiveness, as endorsed and applied by the Appellate Body in the *United States - Gasoline* case:

> One of the corollaries of the 'general rule of interpretation' in the Vienna Convention is that interpretation must give meaning and effect to all terms of the treaty. 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.[139]

Canada argues that Brazil's interpretation, if it were accepted, would give no meaning to the phrase "subject to compliance with the provisions in paragraph 4." Such an interpretation is not tenable.

4.150 Canada further submits that Brazil's letter sent to the Chairman of the DSB, dated 23 September 1996, demonstrates that it agreed that it had to *invoke* Article 27 in response to Canada's challenge. It states "Brazil reserves its rights to invoke Article 27 of the Agreement on SCM before any Panel established to examine the matter at issue, and requests that the terms of reference proposed by Canada explicitly recognise Brazil's right to do so." Canada asserts that it was under no obligation to include Article 27 in its request for a Panel and that it recognises Brazil's right, as an "other developing country" under Article 27.2(b), to invoke Article 27 as a positive defence. However, as Brazil has not shown that it meets the conditions contained in Article 27.4, PROEX does not benefit from the exception contained in Article 27.

2. Which party bears the burden of proof

4.151 **Canada** argues that Article 27 is an exception to the application of Article 3 of the SCM Agreement. This is because Article 27.2 does not contain a substantive obligation that is capable of violation. The only consequence of inconsistency with Article 27.2 (that is, non-compliance with the conditions set out in Article 27.4) is that the exemption from Article 3 contained in Article 27.2 would not apply. This is the sense in which Article 27.2 is an exception, the burden of establishing which rests with the party invoking it, rather a substantive obligation that must be proven by the complaining party. Irrespective of how Article 27 is characterised, the burden of proof does not shift to the complaining Party. This is because it is Article 3.1(a) which sets out the general prohibition on export subsidies. Where a complainant alleges that a WTO Member is providing subsidies that are inconsistent with Article 3, it has the burden of establishing its claim. If it does so, then the responding party has the burden of establishing that the claim of the complainant is unfounded. This is a negative defence. Alternatively, a responding party may argue that it benefits from the provisions of another Article or Agreement or, indeed, principle of international law, that could supersede the claim already established. This is an affirmative defence, and the party advancing such a claim has the burden of establishing it. Whether this is called an exception or a special regime is immaterial to the underlying issue: an affirmative defence that has the potential of trumping the claim of a complainant, when that complainant has met its burden of presenting a *prima facie* case, must be established by the Party advancing that defence.

4.152 Canada submits that the weight of the burden, of course, varies from case to case, and from provision to provision. For example, developing countries that are identified in Annex VII to the SCM Agreement may dispose of their burden simply by referring to the Annex. This is manifestly not the case with respect to "other" developing countries. Canada agrees that the affirmative defence of Article 27 may be invoked as a matter of legal right. At the same time, developing countries that expect to benefit from the grace period must establish that they meet the conditions set out in that Article. This is no different from saying that any Member that wishes to take advantage of its legal right to enact measures that would fall under GATT Article XX would have to meet the criteria in the introductory paragraph of GATT Article XX. Accordingly, if Brazil claims that Article 27 applies to it, Brazil must establish that it

[139] *United States - Standards for Reformulated and Conventional Gasoline*, W/DS2/AB/R, report of the Appellate Body adopted on May 20, 1997, at 23.

falls properly within its terms. That is, it must establish that it is a developing country Member and that it is using the eight-year period to phase out its prohibited subsidies; that it is not using this period to increase its level of subsidies; and that it is phasing them out earlier if the subsidies no longer serve its development needs. Brazil, as the party advancing the affirmative defence, has the burden of proving that it has met the conditions set out in Article 27, in particular Article 27.4, to be able to benefit from such an exception. It has not done so.

4.153 **Brazil** disagrees with Canada that it has the burden of proof in this case. It argues that if Canada's interpretation of Article 27 were to be accepted, it would reverse the bargain which was struck during the Uruguay Round. [140] It submits that Article 27 is not an exception to Article 3. Like other provisions dealing with special and differential treatment for developing countries and economies in transition, it is co-equal with all other Articles of the WTO Agreement. It is in no way subordinate to Article 3 or any other Article of the SCM Agreement. Brazil further submits that Article 27 is a transitional arrangement that, by its own terms, will terminate eight years after entry into force of the WTO Agreement.

4.154 In response to a question from the panel,[141] Brazil argues that the crucial question is which party bears the burden of proof. As the Appellate Body recognized in *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses*[142] international tribunals have generally and consistently accepted and applied the rule that the party who asserts a fact is responsible for providing proof. Brazil submits that since Canada claims that Brazil is not entitled to the protection of Article 27.2, it is Canada's burden to show, pursuant to Article 27.4, that Brazil has increased the level of its export subsidies. Brazil argues that Canada's attempt to impose the burden of proof on Brazil is an attempt to negate the temporary special and differential treatment provisions for which Brazil and other developing countries specifically negotiated during the Uruguay Round.

4.155 Brazil disputes Canada's argument, presented at paragraphs 70 and 71 of its first written submission, that Brazil must show that its "exercise of the right under the limited and conditional exception set out in Article 27 does not 'devalue or 'negate' the rights of other WTO Members under Article 3." Brazil notes that the language used by Canada comes from the Appellate Body Report in *United States – Import Prohibition of Certain Shrimp and Shrimp Products*.[143] It construes Article XX of

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[140]In this respect, the Panel posed the following question to Brazil: "Brazil argues in its second oral statement that '[d]eveloping country Members bargained for the temporary exemption of Article 27, *and for the 'material advantage' language of item (k)* precisely because, when Article 27's protection expires, they needed something they could afford in view of the fact that the developed countries had their self-designed exemption, which is presently in the second paragraph of item (k).' (Emphasis added). Taking into account that the 'material advantage' clause of item (k) was imported unchanged from the Tokyo Round Subsidies Code, can Brazil adduce any support for this assertion?" Brazil responded as follows: "It is true that the 'material advantage' clause was in the Tokyo Round Code. However, during the Uruguay Round a proposal was made by a developed country to delete the language. Brazil and other developing countries opposed this initiative. Attached as Exhibit Bra-19 is a copy of a 7/7/90 proposed change to the Illustrative List. The proposal was rejected and the language remained in item (k)." **Canada** points out that there is no mention of "developing country" in item (k), if indeed this were something developing countries for. In any event, as Canada has observed, given the explicit wording of item (k) - which does not restrict its application to developing countries - if Brazil's interpretation for item (k) were accepted, it would simply encourage competitive export subsidisation, by developed and developing countries alike. Such a proposition is hardly to be welcomed by developing countries that would have to compete with legal export subsidies paid by developed countries. As well, nothing in the document adduced by Brazil identifies the proposal to remove the last clause of item (k) as one advanced by a developed country; nothing in the document suggests that the opposition to the proposal was based on development status; nothing indicates that the failure to remove this clause was something that developing countries bargained for. Brazil's interpretation thus places as much strain on the negotiating history as it does on the plain text, read in context, of item (k), and must therefore be rejected.

[141]Brazil's Response to Questions From the Panel, No. 16.

[142]*United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, report of the Appellate Body adopted on 23 May 1997.

[143]*Supra* note 49.

GATT 1994, which lists "*General Exceptions"* to that agreement. But Brazil argues that Article 27 of the SCM Agreement is very different. It is not a "general exception" but a temporary *exemption* that was bargained for in the Uruguay Round. It does not "devalue" or "negate" rights of other WTO Members, but simply delays the imposition of certain new obligations on developing countries. The fact that developing countries are exempt from the requirements of Article 3.1(a) for a period of eight years does not mean that Members must endure adverse effects from developing country exports for eight years. Brazil notes that if those subsidies are causing adverse effects, Members have a remedy in Article 7.[144]

4.156 In this regard, citing paragraph 7 of Canada's First Written Submission, Brazil notes that Canada's stated purpose in bringing this dispute was because of the alleged "damage caused by PROEX subsidies." Brazil argues that if this is indeed the case, then by the terms of Article 27.7, Canada may pursue the remedies set out in Article 7 of the Subsidies Agreement. Brazil believes that the reason Canada both complains about the alleged negative impact of PROEX on its regional aircraft industry and fails to pursue an Article 7 remedy is that Canada knows it cannot show the required negative impact.[145]

4.157 Brazil submits that the clearly stated object and purpose of Article 27 is to provide special and differential treatment to developing country Members. Its context is made clear from its first paragraph which states without qualification that, "Members recognise that subsidies may play an important role in economic development programmes of developing country Members." The Article consists of carefully negotiated language that reflects a carefully drawn balance of rights and obligations of Members. Its text states explicitly and unequivocally that "the prohibition of paragraph 1(a) of Article 3 shall not apply" to developing countries, subject to specified conditions. It is the burden of Canada, as the complaining party, to establish that Brazil has not complied with these conditions.

4.158 Brazil acknowledges that it does have a responsibility under Article 27, but that responsibility is not the burden of establishing the applicability of Article 27. Brazil's sole responsibility under Article 27 is the duty imposed on all Members by public international law under the "rule of collaboration," recognised by the Panel in A*rgentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items.*[146] That is the duty to make available to the Panel and the parties relevant information in its sole possession. Brazil claims to have satisfied this obligation by making available data to enable an assessment to be carried out to determine whether it has met the condition imposed by Article 27.4. Brazil asserts that the duty to collaborate in the production of relevant information is not the same as the burden of establishing the non-applicability of article 27. That is the responsibility of Canada, and that is a responsibility that Canada has not met. Canada has not even alleged that Brazil has acted contrary to the requirements of Article 27, let alone produced positive evidence in that regard.

3. Arguments relating to Article 27.4 of the SCM Agreement

4.159 **Canada** states that it agrees that Brazil is a developing country within the meaning of Article 27.2(b), but does not agree that Brazil has met the remaining conditions imposed by Article 27.4. **Brazil** argues that it has met all the conditions imposed by Article 27.4, and it is up to Canada to prove the contrary.

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[144]Brazil's Response to Questions From the Panel, No. 22.
[145]*Ibid.*
[146]*Supra* note 22.

(a) Whether Brazil has increased its level of export subsidies

4.160 **Brazil** submits that when PROEX began in 1991, it took over the existing liabilities and responsibilities of an earlier programme, FINEX, which was terminated. In addition, at that time, Brazil maintained an export subsidy programme called BEFIEX ,which provided tax relief for exporters. Table 1 sets forth the PROEX budget for each year since its 1991 inception through 1998, as well as the amount of taxes relieved under BEFIEX from the same year, 1991, through 1997. As could be seen from the Table, both PROEX and BEFIEX individually are below their 1991 levels, as is their combined total. Accordingly, Brazil argues that it has not increased the level of its export subsidies since 1991.

TABLE 1

Level of Brazil's Export Subsidies

(Figures in US$ millions)

Year	PROEX Budget	BEFIEX – Taxes Relieved	PROEX & BEFIEX
1991	1,594.22	445.9	2,040.12
1992	627.20	298.0	925.20
1993	1,440.39	199.2	1,639.59
1994	981.38	218.8	1,200.18
1995	1,069.79	146.0	1,215.79
1996	495.08	102.3	597.38
1997	834.43	59.2	893.63
1998	1,263.01		

Source: *Brazilian Government*

4.161 **Canada** disagrees with Brazil that it has not increased the level of its export subsidies. Canada notes that Brazil's budget allocation for export subsidies in 1998 exceed the 1994 level, and that the PROEX budget that the Government has requested from the Brazilian Congress for 1999 would bring Brazil's budget allocation to a level that is 10 per cent greater than the 1994 benchmark. Canada challenges the selection of 1991 as the benchmark year, and argues that expenditures as opposed to budgetary amounts should be calculated in order to determine whether Brazil has complied with its obligations under Article 27. Relying on Tables 2 and 3 below, Canada claims that Brazil has increased total expenditures by 40 per cent since 1994. This increase was based on a comparison of 1994 figures with figures for the first nine months of 1998. Comparing the first ten months January – October 1998 with the full twelve months of 1994, the increase in Brazil's expenditures on export subsidies is now 53 per cent as seen from Table 2. Canada subsequently revised this figure to 60 per cent based on PROEX expenditure figures provided by Brazil in its Second Written Submission to the Panel for the January - October 1998 period ($538 million rather than $520 million as shown in Table 2).

TABLE 2

PROEX and BEFIEX Expenditures US$ millions			
Year	PROEX	BEFIEX	TOTAL
1994	121	219	340
1995	124	146	270
1996	184	102	286
1997	353	59	412
1998 (Jan-Oct)	520	0	520

Source: PROEX: 1994-1997: Banco do Brasil; Estado do Sao Paulo

Canada argues that if expenditures in November and December are equivalent to average monthly expenditures in the first ten months of this year, expenditures on export subsidies in 1998 will be over 80 per cent higher than in 1994. This increase in expenditure is fully consistent with the stated objectives of the Government of Brazil as articulated by President Fernando Henrique Cardoso during the third anniversary of the "Real Plan":

> "Among [the measures aimed at reducing the "Brazil cost"] are: a) an extensive reformulation of the Export Financing Program (… PROEX), expanding the List of eligible products and extending financing to the production phase to make it more attractive and effective. Whereas the government paid out US$82 million and US$115 million in 1995 and 1996, respectively, expenditures of no less than US$1 billion are anticipated for 1997."

4.162 Canada submits that while expenditures have not yet reached the level of US$1 billion forecast by the President, PROEX expenditures solely for the purpose of supporting EMBRAER aircraft already scheduled to be delivered in 1999 will total $400 million as demonstrated in Table 3 below.

TABLE 3
Proex Expenditures to Support Embraer Sales
(Million US$)

Year	Total Export Subsidies	PROEX to Support EMBRAER Sales	Percentage of Total Export Subsidies
1996	286	31	11%
1997	412	122	30%
1998 (9 Months)	472	219	46%
1998 (Forecast)	624	282	45%
1999 (Forecast)	?	399	?

Source: Total Export Subsidies : 1996-1998 Jan-Sept : Banco do Brasil

Canada argues that these increases in expenditures under PROEX have not been accidental. On the contrary, they are the result of concerted expansions in the scope of the programme. The changes to PROEX since the entry into force of the SCM Agreement include: the increase of the coverage of interest equalisation from 85 to 100 per cent of the value of the export; lengthening of the PROEX term for aircraft from 10 to 15 years; the expansion of the list of eligible products by over 30 per cent; the introduction of lump sum payments of equalisation; the extension of interest equalisation to financing for the production of exports and, most recently, the elimination of restrictions on the use of PROEX financing and equalisation in the same transaction. These very expansions support Canada's later

submission that Brazil has taken no steps to *phase out* PROEX, as it is required to do under Article 27(4).

4.163 **Brazil** does not contest the accuracy of the data submitted by Canada from 1994 through the third quarter of 1998. Brazil argues that since 1991 is the year PROEX was established, it must be the proper starting benchmark for this comparison.[147]

4.164 Brazil submits that Canada chose to ignore the data from 1991 through 1993 and, as a result, provided the Panel with a distorted picture of Brazil's expenditures regarding export subsidies since PROEX's inception. Brazil refers the Panel to Exhibit Bra-10 which, according to it, provides the complete series of expenditure data from 1991 through 1997, and preliminary data for the period from January through October 1998.[148]

TABLE 4

Complete Series of PROEX Expenditure Data from 1991 through 1997, and Preliminary Data for the period January through October 1998

PROEX and BEFIEX Expenditures US$ millions			
Year	PROEX	BEFIEX	TOTAL
1991	342	459	788
1992	215	298	513
1993	197	199	396
1994	121	219	340
1995	124	146	270
1996	184	102	287
1997	353	59	413
1998(Jan-Oct)	538		538

Source: Exhibit Bra-10

Similarly, for comparison and at the request of the Panel,[149] Brazil submitted a chart showing expenditures from 1991 through partial 1998 in constant 1991 dollars (Table 4 is not in constant 1991 dollars).[150] In addition, Brazil also submitted the information from 1985 through partial 1998 in constant 1991 US dollars.[151]

[147] Brazil's Response to Questions From the Panel, No. 19.
[148] Brazil's Response to Questions From the Panel, No. 19.
[149] Brazil's Response to Questions From the Panel, No. 44.
[150] Exhibit Bra-20 (see Table 5).
[151] Brazil's Response to Questions From the Panel, No. 45; Exhibit Bra-21.

TABLE 5

PROEX Expenditures from 1985 through 1997, and Preliminary Data for 1998 in Constant 1991 U.S. Dollars

PROEX and BEFIEX Expenditures 1991 US$ millions			
Year	PROEX	BEFIEX	TOTAL
1985	1,609	427	2,036
1986	1,298	602	1,900
1987	1,200	506	1,706
1988	1,154	544	1,698
1989	866	461	1,327
1990	489	533	1,022
1991	342	446	788
1992	209	290	499
1993	187	189	376
1994	112	203	315
1995	112	132	244
1996	164	91	255
1997	308	52	360
1998(Jan-Oct)	465		465

Source: *Exhibit Bra-21, Exhibit Bra-20.*

4.165 Further, Brazil maintains that it has not increased the level of its export subsidies and corrected two errors in Table 1. First, Brazil states that it omitted to indicate that the PROEX value for 1998 was calculated using the average exchange rate for the period January through September. The values of previous years were calculated with the average exchange rate for the entire year. This means that the 1998 PROEX budget indicated in Table 1 is "inflated," since it does not take into account the devaluation of the Real against the US dollar in the last quarter of 1998. Second, Brazil did not adjust the US dollar amount to which Brazilian currency had been converted to make the comparison in constant 1991 dollars. Brazil argues that it is absolutely necessary when measuring the level of export subsidies over an eight-year period to use a constant point of comparison. Thus adjusted, Brazil introduced evidence which showed that the current level of export subsidies is even further below the 1991 benchmark.

TABLE 6

Brazil's Export Subsidies in Constant 1991 U.S. Dollars

PROEX and BEFIEX (Budget—1991) US$ millions			
Year	PROEX	BEFIEX	TOTAL
1991	1,594	446	2,040
1992	610	290	900
1993	1,366	189	1,555
1994	909	203	1,111
1995	968	132	1,101
1996	440	91	531
1997	728	52	780
1998(Jan-Oct)	1,092		1,092

Source: *Exhibit Bra-11*

4.166 Brazil, continuing to dispute Canada's assertion that the appropriate benchmark was 1994, further submitted data, which according to it, established that even if 1994 was used, Brazil's level of export subsidies in subsequent years, when measured against 1994 in constant dollars, had not increased.

TABLE 7

Brazil's Export Subsidies in Constant 1994 U.S. Dollars

PROEX and BEFIEX (Budget—1994) US$ millions			
Year	PROEX	BEFIEX	TOTAL
1994	981	219	1,200
1995	1,046	143	1,188
1996	475	98	573
1997	786	56	842
1998(Jan-Oct)	1,179		1,179

Source: Exhibit Bra-12

4.167 **Canada** disagrees with Brazil that Article 27 mandates the use of constant dollars. It argues that there is no provision in Article 27 for conversion of the level of export subsidies into constant dollars and that if the drafters of Article 27 had intended the benchmark to be adjusted for inflation, they would have specifically provided for it. That is what they did in Annex IV of the SCM Agreement. Canada further argues that it is immaterial whether constant or current dollars is used, as in both cases, the level of Brazilian export subsidies increased since the entry into force of the WTO Agreement, as demonstrated in Table 8 below.

TABLE 8

Brazilian Export Subsidies (PROEX AND BEFIEX) Measured in Constant and Current Dollars from 1994

	Total Expenditures (current US$)	Total Expenditures (1994 constant US$)
1994	339.6	340
1995	269.5	263
1996	286.7	275
1997	412.5	389
1998**	537.8	502

Source: Brazil exhibit 20

(i) Which year is the appropriate benchmark year

4.168 **Canada** submits that the figures submitted by Brazil to demonstrate that its level of export subsidies have not increased are not relevant, as the selection of 1991 as the benchmark year is erroneous. Canada argues that the relevant base year for determining whether there has been an increase in the level of export subsidies under Article 27.4 is 1994, as the condition in Article 27.4 became effective on 1 January 1995. Thus, to benefit from the Article 27 exception, developing countries may not increase their level of export subsidies as of 1 January 1995. Any increase in the level of export subsidies prevailing as

of the date of entry into force of the WTO Agreement would mean that the developing country in question would lose the exemption provided in Article 27.

4.169 Canada submits that its interpretation is supported by footnote 55 to Article 27.4, which makes it clear that the benchmark period is one calendar year. Footnote 55 provides that "[f]or a developing country Member not granting export subsidies as of the date of entry into force of the WTO Agreement, this paragraph shall apply on the basis of the level of export subsidies granted in 1986." Canada submits that since Brazil was granting export subsidies on the date of entry into force of the WTO Agreement, the exception in footnote 55 does not apply and that the appropriate benchmark period for determining whether there has been an increase in the level of export subsidies is the calendar year immediately preceding 1 January 1995, i.e.,1994.

4.170 **Brazil** argues that given the peculiar circumstances of this case, 1991 is the appropriate benchmark, especially considering that it is the year in which PROEX was first enacted. The benchmark for other cases may be different, depending upon the circumstances of those cases. Brazil asserts that Canada's proposal to use 1994 as the benchmark could have a widely diverse impact, depending upon the particular circumstances of a developing country in 1994. Should the Panel adopt Canada's suggestion, given the volatile nature of developing country economies, the benefits for which they negotiated in Article 27 might not be available to them, depending upon circumstances beyond their control.

4.171 Brazil submits that if the Panel does not choose to utilise a benchmark year reasonably tailored to the case before it, the Panel should consider utilising a weighted average of the three or four years prior to the entry into force of the WTO Agreement as the benchmark. This methodology, argues Brazil, would help reduce the distortion of the impact of a single year on the volatile economies of developing countries. Brazil notes, in that connection, that the PROEX budget in the period 1991-1998 experienced an average year-to-year swing of 43 per cent in US dollars. Brazil believes that other developing countries are likely to present similar patterns.

4.172 **Canada** argues that there is nothing in the text of Article 27.4, nor indeed the context of Article 27 in the SCM Agreement as a whole, which supports Brazil's interpretation. Canada submits that designating as the benchmark the year that a programme begins is inconsistent with the language of Article 27.4. If Brazil's interpretation were to be accepted, it would mean designating a different benchmark year for each export subsidy programme that makes up a developing country Member's overall export subsidies, with the exception of agricultural subsidies. Such a situation will be inconsistent with the plain language of footnote 55 of the SCM Agreement, which designates 1986 as the single benchmark year for a developing country Member's overall export subsidies where that Member does not grant export subsidies as of the date of entry into force of the WTO Agreement.

4.173 Canada submits that it is clear from the text of the SCM Agreement that 1994 is the benchmark year for Article 27.4. Given that the SCM Agreement became effective on 1 January 1995, the condition regarding increase of export subsidies became effective as of that time. The level of export subsidies at that time must be the level in 1994. This interpretation is confirmed by Footnote 55, which provides the reference to export subsidies granted as of the date of entry into force of the WTO Agreement, as well as reference to a calendar year.

4.174 Canada submits that Brazil's interpretation would produce absurd results. It is not unusual for a subsidy programme to initially be administered at a low level, with an increase over time. This would be the case particularly with respect to developing country Members that initiated subsidy programmes years ago and had increased these budgets significantly by 1994. Brazil's interpretation would seriously

prejudice the export subsidy programmes of such developing country Members. Canada further submits that Brazil's argument that Canada's interpretation is too rigid and would "impose a benchmark on developing countries over which they have no control" is without merit. Canada asserts that the opposite is true, as the negotiation of the WTO Agreement was completed at the end of 1993. Members planning to invoke Article 27 knew that their phase out obligations under Article 27.4 would apply as of January 1, 1995. In any case, the argument that Members have no control over the 1994 benchmark makes no sense in relation to an obligation freely entered into by states.

4.175 Canada also disagrees with Brazil that the Panel should consider using a weighted average of the three or four years prior to the entry into force of the WTO Agreement. It notes that such an interpretation is completely without support in the text and context of the SCM Agreement. Where the WTO Agreements specify that averaging over a period of years should be used, it is done so expressly as in Article 6.3(d) of the SCM Agreement, Article 5.1(b) and Annex 2 of the Agreement on Agriculture and paragraph 6(a) of the Understanding on the Interpretation of Article XXVIII of the General Agreement on Tariffs and Trade 1994. Furthermore, Brazil's interpretation is inconsistent with the use of a single year as a benchmark in footnote 55 of the SCM Agreement. Brazil's alternate interpretation would apply a different standard to developing country Members falling within footnote 55 and other developing country Members. The former would be subject to a calendar year benchmark, while the latter would be subject to a multi-year weighted average. Canada submits that its interpretation avoids this inconsistency by applying the same standard in both instances – the level of export subsidies granted over a calendar year.

(ii) What are the relevant indicators for determining whether a Member has increased the level of its export subsidies

4.176 The parties are agreed that, in determining whether a Member has increased its level of export subsidies under Article 27.4 of the SCM Agreement, regard should be had to the overall level of subsidisation, not the level of export subsidies for some given product, however defined. They disagree, however, whether agricultural subsidies should be included in the calculation. **Canada** is of the view that the phrase "level of export subsidies" in Article 27.4 excludes agricultural subsidies that conform to Part V of the Agreement on Agriculture in accordance with Article 13(c) of that Agreement. It claims that this interpretation of the phrase is consistent with the context of Article 27, as agricultural export subsidies are subject to special rules and separate reduction commitments in the Agreement on Agriculture. This is confirmed in the reference at the beginning of Article 3 of the SCM Agreement: "Except as provided in the Agreement on Agriculture." Article 27 provides an exception to Article 3, and not to the Agreement on Agriculture. Accordingly, the phase out requirement in Article 27.4 must also apply "[e]xcept as provided in the Agreement on Agriculture." Such an interpretation is also consistent with Article 13(c) of the Agreement on Agriculture, which exempts from the prohibition in Article 3, agricultural export subsidies that conform fully with Part V of the Agreement on Agriculture. Given that such subsidies are already exempted from the application of Article 3, they should not be included in the calculation of subsidies for the sole purpose of determining whether *another* exception would be available.

4.177 **Brazil** disagrees with Canada that agricultural subsidies should not be included in the calculation of the level of export subsidies. In its response to a question[152] from the Panel as to whether it agreed with the interpretation proposed by Canada, it stated that "Article 27 makes no distinction between subsidies granted to agricultural or industrialized products. The calculation of the level of export

[152]The question posed by the Panel was as follows: "…Does Brazil agree that agricultural subsidies should not be included in performing the calculation of the level of export subsidies…?"

subsidies should include all export subsidies being granted as of the date of entry into force of the WTO agreement." Brazil stated, however, that neither PROEX nor BEFIEX are agricultural subsidies, nor are they granted for the benefit of agricultural products. BEFIEX benefited industrial firms that imported inputs or capital goods and exported industrialised goods, while PROEX benefited Brazilian capital and consumer goods as well as services.[153]

(iii) Whether "level of export subsidies" refers to expenditure or to budgetary appropriations

4.178 **Canada** argues that the phrase "level of export subsidies" appearing in Article 27.4 refers to expenditures, not budgetary appropriations, as claimed by Brazil. Canada submits that when viewed in isolation, the ordinary meaning of "level" could encompass either expenditures or budgeted amounts. However, viewed in its context within the SCM Agreement and the other WTO agreements, "level of export subsidies" can only be interpreted to refer to expenditures.

4.179 Three contextual aspects of the SCM Agreement and other WTO agreements support this interpretation. First, starting from the definition of subsidies in Article 1, the SCM Agreement as a whole is phrased in terms of transfers of value, such as when payments are made, and not the amount that a Member has budgeted for subsidies – that is, the amount that a Member intends or expects to transfer. For example: (a) Article 1.1(a)(1) refers to a "financial contribution" by a government, and not to the budgeting of a financial contribution; (b) Article 1.1(a)(1)(i)-(iv) refers to "direct transfers of funds," foregone revenue, the provision of goods and services, and payments to a funding mechanism rather than budgeting for such activities; (c) Article 3.2 provides that Members shall not grant nor maintain export subsidies, but does not constrain them from budgeting for such subsidies; (d) the dispute settlement mechanism in Article 4 can be invoked when a Member has reason to believe that a prohibited subsidy is being "granted or maintained," not just when such subsidies are budgeted or planned; and (e) the notification provisions in Article 25 state that the primary basis for notifying subsidies is on an expenditure basis – only where this is not possible, should such notification be done on a budgetary basis. This indicates that where budgeted amounts were intended, they were specifically provided for.

4.180 Canada argues that the text of footnote 55 to the SCM Agreement defines the base year for determining whether certain developing country Members have increased the level of their export subsidies in terms of "the level of export subsidies granted in 1986." Footnote 55 does not refer to the level of export subsidies "budgeted." Third, where disciplines have been imposed elsewhere in the WTO agreements on levels of subsidies, the disciplines are based on expenditure levels. The Agreement on Agriculture establishes base levels for domestic and export subsidies on an expenditure basis. Where that Agreement refers to "budgetary outlays," the term is understood to mean government expenditures, not budgeted amounts.

4.181 Canada argues that interpreting the phrase "level of export subsidies" to mean expenditure levels is also consistent with the object and purpose of the SCM Agreement: to reduce the economic distortions caused by subsidies. Economic distortions are caused by actual expenditure of export subsidies, not by budgeting or planning for such subsidies. Brazil's interpretation would imply that a developing country Member could have budgeted a large amount of export subsidies in 1994 without having to expend them, only to expand its actual expenditure of export subsidies.

4.182 Second, Canada also argues that the Brazilian interpretation would create an absurdity. It could create a situation where a developing country Member that does not grant any export subsidies could lose the protection provided by Article 27 if it budgets for export subsidies at a level higher than its 1994

[153]Brazil referred to WTO Doc. G/SCM/Q2/BRA/8.

calendar year baseline. Conversely, a Member that maintains its budget at its previous level, but overspends on actual expenditures, would not be in breach of this condition.

4.183 **Brazil** disagrees with Canada that its interpretation is supported by the text of the SCM Agreement. It argues that the approach adopted by Canada in arriving at that judgment ignores the teaching of the Appellate Body in *United States – Import Prohibition of Certain Shrimp and Shrimp Products*: "A treaty interpreter must begin with, and focus upon, the text of the particular provision to be interpreted. It is in the words constituting that provision, read in their context, that the object and purpose of the states parties to the treaty must first be sought."[154] Brazil alleges that Canada disregarded this teaching of the Appellate Body as it looked at "other articles of the SCM Agreement, Articles 1, 3, 4, 25, and even to another Agreement - the Agreement on Agriculture.

4.184 Brazil submits that Canada does not accurately reflect what those other Articles specify. For example, Canada claims that "the notification provisions of Article 25 state that the primary basis for notifying subsidies is on an expenditure basis – only where this is not possible," Canada continues, "should such notification be done on a budgetary basis." But Brazil argues that the notification provisions of Article 25 state nothing of the kind. The relevant provision is Article 25.3 (ii) which provides:

"Members shall ensure that their notifications contain the following information:

***

(ii) subsidy per unit or, in cases where this is not possible, the total amount or the annual amount budgeted for that subsidy (indicating, if possible, the average subsidy per unit in the previous year);"

4.185 Brazil submits that whereas the word "expenditure" does not even appear in the article, the word "budgeted" clearly does appear and clearly is a proper basis. Brazil argues that it is clear that this provision states a preference for reporting on a per unit basis. But for a subsidy like PROEX, this is not possible. It does not operate on a per unit basis. Therefore, "the total annual amount budgeted for that subsidy" quite properly was the basis for Brazil's notification to the Subsidies Committee, and is the appropriate benchmark for measuring the level of subsidies for this reason as well as for the reasons given by Brazil. Brazil argues that the budgeted amount includes the total value of all commitments contracted for or anticipated in the coming year. Thus, to take a simple example: If a commitment has been made to provide PROEX benefits for a single airplane to be exported in the coming year, and if the total amount of payments on that single airplane over 15 years is $3 million, the entire $3 million is included in the budget for the coming year.

4.186 Brazil submits that budgeted amounts, rather than expenditures, are the proper basis of comparison because they are the responsibility of the Member governments of the WTO. The degree to which a government's budgeted amount may be utilised in any given year is determined not by the government, but by the private sector. Under Canada's approach, a Member could increase its budgeted amounts and meet the requirements of Article 27.4 if, for whatever reason, private sector utilisation declined. Conversely, a government progressively phasing out its subsidies would not be in compliance if the private sector utilised a sufficiently larger share of a smaller budget. The Canadian approach puts the responsibility for establishing the level of export subsidies on the private sector, not on Member

[154] *United States – Import Prohibition of Certain Shrimp and Shrimps products*, WT/DS58/AB/R, para 114, report of the Appellate Body adopted on 6 November 1998.

governments. Apart from the amounts they budget, however, governments have no control over expenditures. An approach that would result in the determination being made on the basis of private action rather than government decision should not be utilised.

4.187 Brazil claims that the Canadian argument that budgets may be overspent and therefore are not a reliable measurement of the level of export subsidies misunderstands the Portuguese term "dotação orçamentária" which has, somewhat loosely, been translated as "budget." This term does not mean budget in the sense of a statement of probable or estimated expenditures that may or may not be accurate. In context it corresponds to "budgetary appropriation." PROEX budget numbers are actually the "dotação orçamentária" for the programme. They refer to the specific amount of funds reserved for payment to the beneficiaries of the programme. Payments may not be made when the funds of the "dotação orçamentária" are depleted. Consequently, there is no possibility of overpayment of the budgeted amount – more accurately the budgetary appropriation – as suggested by Canada.

4.188 Brazil submits that Canada's interpretation of footnote 55 does not give a complete picture. While Canada points out the absence of the word "budgeted" in the footnote, it does not mention the absence of the word "expenditure" or "paid" or any other term that would signify an actual expenditure. The negotiators certainly could have used such a term if that was what they meant. That in fact is what they did in the Agreement on Agriculture where the term used is "budgetary outlay." The ordinary meaning of the verb "grant" appearing in footnote 55 is "to agree, consent" or "to promise, undertake (which means 'to give formal promise or pledge')." This is, in fact, what the Portuguese term "dotação orçamentária" signifies: a formal, legally binding promise – not an estimate – to the Brazilian exporter or financial institution to provide the funds earmarked for PROEX in the budget, on a first-come first-served basis, until the appropriated resources are depleted.

4.189 Brazil submits that while it agrees with Canada that the use of expenditure levels is consistent with the object and purpose of the Subsidies Agreement, which is to "reduce the economic distortions caused by subsidies," it is also of the view that budgetary appropriation levels are also consistent with this particular objective of the Agreement. Brazil further submits that the Canadian argument that its interpretation would produce absurd results is without merit. Brazil argues that if a developing country Member were to budget a large amount of export subsidies in 1994 without having to expend them, only to expand its actual expenditure of export subsidies, such an approach would raise serious issues under Article 18 of the Vienna Convention on the Law of Treaties, which obliges states to refrain from acts which would defeat the object and purpose of a treaty prior to its entry into force. Second, to the extent that Members could take such action consistently with Article 18 of the Vienna Convention, this only reinforces Brazil's argument that the Panel should not select one particular year to serve as the benchmark. Third, the historic data demonstrates that Brazil did not artificially expand the 1994 budget numbers, which are lower than those of previous years.[155] Fourth, Canada has presented no evidence that would justify its suggestion that other developing country Members may have acted contrary to their obligations under Article 18 of the Vienna Convention and, in the absence of such evidence, the Panel should not assume that they have.

4.190 Brazil argues that if it is true that developing country Members have the burden of proof and that 1994 is the appropriate benchmark, as argued by Canada, then Article 27 would have been completely unavailable to developing countries in 1995, if the level of export subsidies were measured on an expenditure basis. It would have been impossible for the developing country to prove that the 1995 level was below the benchmark level. For example, suppose a complaint had been brought at a point in 1995 when only first quarter expenditure statistics were available. Suppose that for all of the benchmark year

[155]See Table 4 (Exhibit Bra-10) and Table 5 (Exhibit Bra-21).

(or the average of several years) expenditures were 100 while first quarter benchmark expenditures were 25. Assuming that the comparison should be on a quarter to quarter basis (which is not at all clear from the text) what would be the result if first quarter 1995 expenditures were 30? The fact that the first quarter 1995 subsidies were ahead of the same period in the benchmark period would not necessarily mean that the pattern would hold for the full year. It could well be that the total would be substantially less than the benchmark's hypothetical 100, but how could the developing country prove it? Indeed, at no time during 1995 could a developing country prove the total level of 1995 expenditures, since not all of those expenditures would yet have occurred. Consequently, during 1995, on Canada's theory, Article 27 would have been unavailable to developing countries. For that matter, if the burden of proof is on the complaining party, as Brazil argues, the use of expenditures would mean a developed country also would have been unable to bring a prohibited subsidies case in 1995. No Member could prove what 1995 expenditures would be during 1995 itself.

4.191 Brazil submits that the Canadian suggestion could not be a proper basis for interpreting the provisions of Article 27.4. Whatever the appropriate benchmark, there is nothing in the text, the context, or the object and purpose of Article 27 to support the proposition that one benchmark would be used in 1995 and another in subsequent years.

4.192 Brazil argues that use of expenditures as the measure of the level, particularly when combined with Canada's insistence that it is the developing country that bears the burden of proof under Article 27, would have resulted in Article 27's being a complete nullity in the first year of the WTO's existence, 1995. If a developing country had been the subject of a prohibited subsidy complaint in 1995, it could not have proved during that year that the expended amount had *not* increased on an annual basis compared to 1994. It could not have done so until the entire year was over because, even though at any given point in the year the expenditures might have been below those of the prior year, it would have been impossible to prove that they could not have exceeded 1994 before the end of 1995. Developing countries effectively would have lost one of the eight years of exemption for which they had bargained.[156]

4.193 Brazil argues that an interpretation that would have rendered Article 27 inoperative for the first year of its existence is not a reasonable interpretation. It contradicts the words of the Appellate Body in the appeal of a case that, itself, began in 1995: *United States – Standards for Reformulated and Conventional Gasoline*. In this case, the Appellate Body stated that an interpretation of the terms of a treaty "must give meaning and *effect* to all the terms of a treaty"[157] (emphasis in original). Canada's interpretation would not have given *effect* to Article 27 during 1995 (emphasis in original).

4.194 Brazil argues that the fact that this problem ended with the end of 1995 does not rescue Canada's flawed interpretation today. There is nothing in Article 27 that would support the view that one method for calculating the level of export subsidies was to apply in 1995 and another method in the subsequent seven years. A method that would not work in 1995 may not, therefore, be used in subsequent years. Canada's method of 1994 as the benchmark and the developing country with the burden of proof would not have worked in 1995, and therefore may not be used in subsequent years. Further, Brazil submits that Canada's claim that Brazil has increased the level of its export subsidies is contradicted by Tables 1,[158] 6[159] and 7,[160] which show that since entry into force of the Uruguay Round Agreements – whether 1991 or 1994 is the proper base year – Brazil has not increased the level of its export subsidies.

[156] Brazil's Second Written Submission, para. 11.

[157] *United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, p.23, report of the Appellate Body adopted on 20 May 1996.

[158] Exhibit Bra-8.

[159] Exhibit Bra-11.

[160] Exhibit Bra-12.

4.195 **Canada** argues that the Brazilian argument that its interpretation would place control in the hands of the private sector is unmeritorious. It states that it finds it odd that any government expenditure could be said to be controlled by the private sector. Canada submits that while the utilisation of PROEX by Brazilian exporters might have been below what the Brazilian Government would have liked at the time of the entry into force of the SCM Agreement, this cannot excuse Brazil from its WTO obligations. Brazil's interpretation, if allowed, would enable it to actually increase the distortions to trade resulting from its export subsidies, as long as those subsidies are below a level that was budgeted but never, in fact, achieved. This would clearly be at odds with the object and purpose of the SCM Agreement.

4.196 Canada disagrees with Brazil that its interpretation would have effectively resulted in developing country Members losing one year of their grace period, i.e., 1995. It submits that the opposite is more likely to be true: it would have been easy for a responding party, at any point in 1995, to demonstrate that its expenditures were below those of the entirety of 1994, as long as it was not radically increasing its level of export subsidies. In effect, the conditions of Article 27 by their very nature require a certain length of time for an accurate and persuasive interpretation of the facts. Canada submits that this is one of the reasons that Canada waited several years before bringing this challenge, as there is now enough data to show conclusively that Brazil has not met the conditions of Article 27.

4.197 Canada contests Brazil's argument that Canada had misinterpreted Article 25. While Canada's argument may have been interpreted as meaning that the word "expenditure" appears in Article 25.3, which is obviously not the case, it is equally obvious that the term "subsidy" in Article 25 must refer to expenditures since, where budgeted amounts are provided for, the word "budgeted" is specifically used in opposition to the general word "subsidy", which can only be taken as meaning expenditures.

4.198 Canada dismisses the Brazilian claim that its budget numbers are not just estimates but authorised expenditures. It would appear that the budget numbers state "total autorizado." Yet in its submissions, Brazil explains how its expenditure statistics, which contain the same figures put forward by Canada, meet the standards of the International Monetary Fund, since they reflect the full face amount on the PROEX bonds issued each year. This, according to Canada, confirms the irrelevance of the budget numbers and the appropriateness of using the expenditure figures, which reflect the value of the PROEX bonds emitted in that year.

4.199 Canada concludes that it is clear from the foregoing that Brazil has not complied with the requirement set out in Article 27.4 that a developing country Member must not increase the level of its export subsidies. While Canada accepts Brazil's definition of its export subsidies including the two programmes PROEX and BEFIEX, it does not accept the submission of Brazil that it has not increased the level of its export subsidies since the entry into force of the WTO Agreement. Brazil's assertion is contradicted by tables 2 and 3 which show that since the entry into force of the WTO Agreement, Brazil has increased the level of its export subsidies.

(b) Arguments relating to the requirement to "phase out" export subsidies within eight years

4.200 **Canada** submits that Article 27.4 of the SCM Agreement, which provides, in relevant part, that "[a]ny developing country Member referred to in paragraph 2(b) shall phase out its export subsidies within the eight-year period, preferably in a progressive manner" should be interpreted in the light of customary rules of international law. Canada submits that the *Concise Oxford Dictionary of the English Language* defines the verb "phase out" as "to bring gradually ... out of use." The adverb "gradually" is further defined as taking place "by degrees, slowly progressive, not rapid, steep, or abrupt."

4.201 The principal interpretative challenge, according to Canada, is how to reconcile the fact that Article 27 expressly indicates only a *preference* for a "progressive" phase-out, while the term "phase-out" itself and its context within Article 27.4 can be read to mean a gradual, or a slowly progressive termination of the scheme over eight years. Canada notes that "progressive" is defined, in reference to tax rates for example, as indicating an "increasing rate." Thus, the internal construction of paragraph 4 indicates that to comply with the "phase-out" requirement, a developing country Member would have to prove that: (a) it is bringing its export subsidies out of use in a staged manner; and (b) it does not intend to bring its subsidies to a "rapid, steep, or abrupt" end before the end of the eight-year period. Canada adds that a developing country Member should, but is not required to, reduce its export subsidies at an increasing rate. It also asserts that a developing country Member must terminate its export subsidies at the end of the phase-out period. "Terminate," in the context of Articles 27 and 3, means to cease granting or maintaining export subsidies. The maintenance of PROEX subsidies beyond the phase out period through the continuation of PROEX export subsidies by the Government of Brazil is inconsistent with this requirement.[161]

4.202 Canada argues that the context of the phase-out requirement, and the object and purpose of the SCM Agreement in general, and Article 27 in particular, support this reading of the term. Canada observes that the SCM Agreement is the most comprehensive set of disciplines on subsidies and countervailing measures ever achieved in multilateral trade negotiations. For that reason, the Article 27 exception should not be read in isolation, either from the other disciplines of the SCM Agreement, or from the historical background from which it emerged. The recognition in Article 27.1 that "subsidies may play an important role in economic and development programmes of developing country Members," should be viewed as part of a broader package of disciplines aimed at controlling the economically distorting impact of specific subsidies. Among such subsidies, export subsidies have the most egregious impact on the international economy. Therefore, the transition period provided for certain developing countries in Articles 27.2(b) and 27.4 should be interpreted and applied as precisely that: a period in which such Members may make the adjustments necessary, in a staged manner, to bring their export subsidies within the ambit of control of Articles 3 and 4.

4.203 Canada submits that the negotiating history of and background to Article 27 provide further support for the above interpretation and analysis. Article 27 is a strengthened version of Article 14 of the

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[161] In this respect, the Panel posed the following question to Canada: [Given the possibility] that the SCM Committee may extend the eight-year period during which a developing country Member may provide export subsidies, [how could it] be determined in advance for what period a developing country Member will be allowed to provide export subsidies, how could a panel conclude in advance of the end of the period that the Member had not complied with its obligation to eliminate its export subsidies by the end of that period? In its response, Canada stated that "… The condition to 'phase out' is not modified by the possibility of an extension. The condition to 'phase-out' has both substance and legal effect regardless of the possibility that the SCM Committee might extend the grace period. This is so for two reasons. First, the condition to 'phase out' is qualified by the imperative 'shall.' If a developing country Member wishes to benefit from the grace period in Article 27, it 'shall' phase out its export subsidies in the interim. In other words, developing countries are given an additional eight years in which they may distort the international economy through export subsidies, but only on condition that they reduce the distortions so caused by phasing out such trade distorting subsidies over the grace period. Second, a developing country Member that wishes to benefit from an extension of the grace period must enter into consultations with the SCM Committee at least a year in advance of the termination date. That is, as soon as a Member 'deems it necessary' to apply export subsidies beyond the eight year period, it must first enter into consultations with the Committee. That Member cannot simply prejudge the Committee's decision by making commitments to pay subsidies beyond the grace period and thereby causing tremendous market disruption. And a developing country Member has to justify to the SCM Committee that the subsidy in question should continue. The extension is not, therefore, unilaterally determined, is by no means certain and as such does not modify the imperative to 'phase out' export subsidies to benefit from the eight-year grace period."

Subsidies Code.[162] The Subsidies Code exempted developing country signatories from the commitment in Article 9 not to grant export subsidies. The principal obligation of developing country signatories was set out in Article 14(5):

> "A developing country signatory should endeavour to enter into a commitment to reduce or eliminate export subsidies when the use of such export subsidies is inconsistent with its competitive and development needs."

4.204 Canada further submits that the evolution of this provision into the much more stringent obligations set out in the SCM Agreement can be traced through early checklists prepared by the GATT Secretariat for the Negotiating Group on Subsidies and Countervailing Measures of the Uruguay Round. Among the points for negotiation was the following:

> "The right of developing countries to grant export subsidies should not be subject to any special conditions or limitations. Export subsidies granted by developing countries should not be subject to countervailing duties or countermeasures if the country concerned agrees to phase out these export subsidies within an agreed time framework."[163]

Canada asserts that in the end, the SCM Agreement provided much stronger disciplines than both the Subsidies Code and the early negotiating objectives of some signatories. The export subsidies of developing country Members other than those set out in Annex VII are subject to strict limitations and conditions. The Subsidies Code's exhortation to phase out export subsidies that were not consistent with the development needs of a developing country signatory has been supplanted by an obligation to phase out those export subsidies within two years for products in which export competitiveness has been reached. All other export subsidies of such developing country Members must be phased out within an eight-year transition period.[164] In keeping with this evolution, and given the clear wording of Article 27.4, Brazil, according to Canada, must prove that it is in the process of bringing out of use, in a staged manner, its export subsidies.

4.205 Canada submits that, on its face, PROEX does not meet these conditions. The expansions to the PROEX programme confirm that Brazil has taken no steps, and intends to take no steps, to phase out the programme. PROEX does not have a termination date and no programme of phased reductions is in place for PROEX subsidies. Moreover, the financing period provided for in the scheme (10 to 15 years) put PROEX subsidies for aircraft outside the eight-year transition period. Most significant, carriers such as American Airlines have firm orders or options to be delivered well after 1 January 2003 on which they expect to be paid PROEX export subsidies. Thus, the Government of Brazil has already committed to paying export subsidies outside the grace period. Canada asserts that the PROEX export subsidy does not meet the phase out condition provided for in Article 27.4, and as such cannot benefit from the exemptions

[162] Agreement on Interpretation and Application of Article VI, XVI and XXIII of the General Agreement of Tariffs and Trade, (the Subsidies Code), The Texts of the Tokyo Round Agreements, (Geneva: General Agreement on Tariffs and Trade, 1986), at page 51.

[163] GATT Documents MTN.GNG/NG10/W/9, 7 September 1987, at page 23; and MTN.GNG/NG10/W/9/Rev.1, 22 October 1987; and TN.GNG/NG10/ W/9/Rev.2, 2 December 1987. The Secretariat noted that the checklist was based on written submissions circulated in other GATT documents. In addition, the Secretariat states that: "[a]n attempt has been made to include also issues raised in oral statements at the three first meetings of the Group. In accordance with its purpose, the checklist contains only issues proposed for negotiations and not comments of a general nature or comments made on other participants' proposals."

[164] "An Analysis of the Proposed Uruguay Round Agreement, with Particular Emphasis on Aspects of Interest to Developing Economies," GATT Secretariat, MTN.TNC/W/122,) MTN.GNG/W/30, 29 November 1993, at page 58 .

provided for in Articles 27.2 and 27.7. All such export subsidies are prohibited by Article 3.1(a) and must be terminated immediately in accordance with Article 4.7.

4.206 **Brazil** disagrees with Canada that it has the burden of establishing its eligibility for the "phase out" clause, or any other clause, in Article 27. Brazil submits that if Canada believes that it is not entitled to the exemption for which it and other developing countries in the Uruguay Round bargained, it is up to Canada to prove it.

4.207 Brazil submits that putting aside the issue of burden of proof, it is clear that the "phase out" requirement in Article 27.4 is not a "phase down" requirement, which is what Canada implies. Article 27.4 specifies that a developing country Member "shall phase out its export subsidies within the eight-year period, preferably in a progressive manner." The ordinary meaning of the words "in a progressive manner" is that there should be a downward trend over the eight years. Yet Article 27.4 states that this should occur "preferably." It is not mandatory. Thus, a developing country that fails to phase out its export subsidies "progressively" does not lose entitlement to Article 27's benefits. Canada attempts to read into this language a requirement to phase export subsidies out of use "in a staged manner," somehow contrasting this "progressive" phase out with the "real" phase out, which would be rapid, steep, or abrupt. There is absolutely no support in the text of Article 27 or any other part of the Agreement for such a requirement.

4.208 Brazil asserts that Canada's argument that PROEX payments over the financing period are inconsistent with the clause, as some of those payments will occur after the eight-year exemption period has ended, is without any merit. Brazil notes that PROEX subsidies are granted in connection with the export sale of the aircraft. They are disbursed every six months for the period of the financing of the aircraft, which, in most cases, is 15 years. These payments are made to the holders of the NTN-I's, which are a form of bond. As each NTN-I becomes due, it is retired. The PROEX subsidy itself is granted when the commitment is made. The entire subsidy is paid when the aircraft is exported. Brazil submits that it includes the full face amount (*i.e.*, undiscounted) in its budget for the year in which the delivery is made, not over the financing period of approximately 15 years. This is in accordance with the standards of the International Monetary Fund which require that the full amount of the subsidy be included in the budget for the year in which it is made available. Thus, to count the later disbursement of funds in accordance with the PROEX commitment as a subsidy would be to double count the subsidy.[165]

4.209 **Canada** asserts that Brazil has misunderstood its submission. It asserts that "phase out" should not be equated with "phase down." "Phase down" simply means "reduce gradually." "Phase out" means "bring gradually out of use." In other words, the term "phase out" includes the idea of "phase down," but also the idea to eliminate at some point. Canada also takes issue with Brazil's use of the Article 27.4 phrase "preferably in a progressive manner" to infer that while there should be a downward trend, this is not mandatory. The word "progressive" means that the phase out should preferably be carried out at an increasing rate. That is to say, the higher the level of subsidies, the higher the rate of reduction – much like progressive taxation.

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[165]Brazil's Second Written Submission, para. 20.

(i) Arguments relating to the issue of inconsistency with developing country Member's development needs

4.210 **Canada** submits that the third condition of Article 27 is that export subsidies shall be phased out in a period shorter than eight years if they are inconsistent with a country's development needs. It argues that this provision is not a self-judging provision and should be applied on the basis of objective standards. Canada suggests that one such standard is the domestic content rules of PROEX established by Brazil.

4.211 Canada argues that domestic content rules are typically incorporated into export financing and export support programmes with the objective of ensuring that a government's expenditure of foreign exchange is focussed on supporting domestic rather than foreign production. Under the terms of the PROEX regulations, exports with a domestic content ratio of 60 per cent or more are eligible for interest equalization payments on 100 per cent of their value. For goods with a domestic content index of less than 60 per cent, the percentage eligible for interest equalization is reduced according to a formula. For example, for the ERJ-145, which has a domestic content index of approximately 15 per cent, the formula dictates that only 55 per cent of the value of the aircraft should be eligible for interest equalization. However, PROEX interest equalization is paid on 100 per cent of the value of the aircraft because of a waiver granted to EMBRAER. Canada also submits that there are provisions for foreign-produced spare parts to be included in the "export" package and these spare parts can make up 30 per cent of the value of the export package. Thus, export subsidy payments can be paid on spare parts with zero Brazilian content.

4.212 **Brazil** disagrees with Canada that in order for it to avail itself of the provisions of Article 27, it has to establish that PROEX is consistent with its development needs. Brazil argues that Article 27 *presumes* that the development needs of developing countries require subsidies, as is made plain by the first paragraph of Article 27, which provides that "Members recognise that subsidies may play an important role in economic development programmes of developing country Members." Brazil submits that under Canada's theory, a Member may challenge any developing country's export subsidies at any time, and the developing country has the immediate burden of proving that they are consistent with its development needs. A developed country, Canada argues, could ask for consultations tomorrow on every developing country Member's export subsidies and begin a process of requiring every developing country to prove that those subsidies are consistent with its development needs. And it could do so a month later, and a month after that in a never-ending process of harassment.

4.213 Brazil argues that such a situation would effectively do away with Article 27. At the very least, it would reverse the bargain of the Uruguay Round. By explicitly recognising the legitimacy of export subsidies for developing countries, Article 27.1 effectively presumes that subsidies are consistent with a developing country's development needs. Article 27.4, in turn, provides that such subsidies shall be eliminated in less than eight years "when the use of such subsidies is inconsistent with" a Member's development needs. That language clearly means that the burden is on the party challenging a developing country's subsidies to prove that the situation envisioned by Article 27.1 has changed by adducing evidence that the subsides in question are inconsistent with a Member's development needs. Brazil submits that any other interpretation would undo the bargain of the Uruguay Round and ignore the holding of the Appellate Body in *United States – Shirts and Blouses*, which makes clear that the burden is on Canada, the challenger to this presumption.[166]

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[166]*United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, report of the Appellate Body adopted on 23 May 1997.

4.214 Brazil argues further that if there is any doubt concerning Brazil's development needs, the following will demonstrate the extent of the needs of Brazil: (a) Brazil experienced a US$30 billion drain on its foreign currency reserve in a matter of days due to factors completely outside Brazil and entirely unrelated to the health of Brazil's economy; (b) Brazil is still suffering the brunt of the international financial crises, and prospects for the near future are uncertain; (c) UNCTAD reports that in 1997 the current account deficit was $33.5 billion, down from a $6 billion surplus four years earlier; (d) the trade deficit in 1997 was nearly $20 billion, contrasted with a $12 billion surplus five years earlier; (e) in the second quarter of 1998 domestic interest rates for borrowers were 92.2 per cent per year; (f) in 1997 the public deficit was 4.3 per cent of GDP; there was a surplus only three years earlier; and (g) unemployment is at the highest level of all the years covered in the UNCTAD report, 1989 through the first half of 1998.

4.215 Brazil argues that the domestic content ratio argument of Canada is without any merit. Noting Article 2 of TRIMs, Brazil notes a certain irony in the accusation, as traditionally there has been the accusation in the GATT that the content requirements of developing countries were too high and burdensome. In any event, there is no domestic content requirement in Article 27, and Canada's attempt to insert one is totally without justification.

4.216 **Canada** disagrees with Brazil that it wants to insert a domestic content requirement into Article 27. Its argument is that PROEX contains domestic content requirements, placed there for reasons related to development needs, and that these requirements are not being fulfilled in the case of aircraft exports. According to Canada, Brazil has not contested this point. Canada submits that the recital of the economic problems facing Brazil as a result of the global financial crises does not establish that PROEX is consistent with its development needs. Brazil should have explained how PROEX helps Brazil overcome these problems or, more generally, contributes to meeting Brazil's development needs, for example by contributing to its foreign exchange earnings.

4.217 In respect of Canada's submission that Brazil should have explained how PROEX helps it to overcome the problems identified in paragraph 4.133 above, and in response to a question[167] from the Panel, **Brazil** stated that:

> "The importance of exports – and PROEX therefore – is not limited to the correction of current account imbalances or to supply additional economic stimulus or job positions, although it is certainly necessary for these purposes. The achievement of a competitive level of exports is an integral part of the major goal of increasing the productivity and "tradability" of the Brazilian economy as a whole. The idea is to do away with the structural and conceptual distortions that resulted from decades of the protectionist "import substitution model." The external market should be viewed not as an occasional alternative to the internal market in times of slow economic growth, but as part of medium and long term strategic planning. The exposure to external markets must be increased and PROEX plays a crucial role in this regard. In an article about the stabilization and opening of the Brazilian economy, economist Antonio Correa de Lacerda underlines the importance of full integration with the world markets and identifies four basic hurdles for the exporting sector: (a) extremely high interest rates (average overnight interest rates are around 30 per cent) and difficult access to internationally competitive financing; (b) a

[167]The question posed by the Panel was as follows: "In its second submission…, Brazil indicated that in its view Article 27 presumes that the development needs of developing country Member require subsidies, but states that it is ready to provide the Panel with support for the position that PROEX is consistent with Brazil's development needs if the Panel so requests. In paragraph 16 of its oral statement to the second meeting of the Panel, Brazil identified development difficulties facing it but did not explicitly explain the link between PROEX interest rate equalisation and those development difficulties. Could Brazil please elaborate?"

> burdensome tributary system; (c) a complex bureaucratic structure; and (d) a significant structural "Brazil cost"…PROEX helps overcome the first of the hurdles listed by Correa de Lacerda and is a crucial factor in the strategy [of the government]…to consolidate the transformation of Brazil into an open and stable economy."

4.218 **Canada** submits that Brazil's explanation amounts to nothing more than a statement that the PROEX export subsidy is necessary to increase exports. This cannot be considered to be a sufficient explanation of why an export subsidy is not inconsistent with Brazil's development needs. Any export subsidy, properly administered, should increase exports. Brazil's explanation in no way rebuts Canada's comment that PROEX, as applied in civil aircraft sector, is inconsistent with Brazil's own view of its development needs as indicated in the very same programme through its domestic content requirements.

E. ARGUMENTS RELATING TO THE PANEL'S RECOMMENDATIONS

4.219 **Canada** argues that as PROEX payments constitute prohibited subsidies within the meaning of the SCM Agreement, Brazil must neither grant nor maintain such payments as stipulated in Article 3.1 of the SCM Agreement. Brazil must not: (i) enter into new arrangements by which PROEX would be paid; (ii) begin paying subsidies promised or committed, such as those in respect of aircraft that have yet to be delivered, including on the conversion of options to firm orders; and (iii) continue to pay PROEX subsidies.

4.220 In addition to the recommendations sought by Canada under Paragraphs 3.1 - 3.3 of this report, Canada further submits that Article 4.7 of the SCM Agreement sets out the specific remedy available to it, as well as the grant of authority to the Panel with respect to the application of Article 3.2. It argues that the Panel may recommend the withdrawal of subsidies already granted where the circumstances of the case and the distortions caused by the subsidies in question warrant such a remedy. In this light, Canada submits that in respect of transactions entered into by EMBRAER and subsidies granted by Brazil in the period between the composition of the Panel and the adoption of the Report of the Panel, the Panel should make a specific recommendation, for the following reason. In a report issued on August 10, 1998, the investment bankers Bear Stearns gave the following advice to prospective customers of EMBRAER aircraft:

> "Finally, cognizant that a WTO decision is eminent [*sic*] and may result in the ending of an attractive subsidy, any remaining potential customers who were considering a future purchase may decide to anticipate orders with EMBRAER over the 12 months before the ruling is handed down."

4.221 Canada submits that the particular circumstances of the regional aircraft market require that the Panel fashion a specific remedy in respect of subsidies granted to induce sales in anticipation of an adverse ruling by the Panel, as termination of PROEX subsidies after the adoption of the Panel report would not, in such circumstances, redress the harm that would be caused by such subsidies. Accordingly, Canada urges the Panel to recommend the withdrawal of subsidies granted pursuant to transactions entered into in the period following the composition of the Panel on October 22, 1998.

4.222 Canada submits that "without delay" in respect of new subsidy arrangements must mean as of the date of adoption of the Report of the Panel by the DSB. Canada further submits that "without delay" in respect of existing subsidies or subsidies already granted means as soon as practicable to terminate the arrangements and, in any event, no later than ninety days after the adoption of the Report of the Panel by the DSB.

4.223 **Brazil** submits that Canada's request for a detailed, specific remedy goes beyond the powers of the Panel to grant even if the Panel were to agree with Canada on the merits of this dispute. Brazil asserts that Article 4.7 of the Subsidies Agreement specifies that, "If the measure in question is found to be a prohibited subsidy, the Panel shall recommend that the subsidising Member withdraw the subsidy without delay." The Panel is authorized to do no more. Specifically, the means by which any withdrawal is accomplished is for the Member concerned to determine. Accordingly, the Panel should reject Canada's request for a specific remedy.

4.224 Responding to the arguments of Brazil and the third parties in this dispute that its request for specific recommendations go beyond the mandate of the Panel, **Canada** made the following two points: First, that at no point had it asked the Panel to "dictate the means by which a subsidy is to be withdrawn." Canada did note that the obligation in Article 3.2 was simple: a Member shall not grant, and shall not maintain, prohibited subsidies. Where such subsidies were found to exist under a programme, Article 3.2 prohibits the granting of new subsidies and the maintenance of existing ones. Canada asked the Panel to recommend that Brazil abide by its explicit obligation in Article 3.2 of the SCM Agreement.

4.225 Second, Canada agrees that it is seeking recommendations from the Panel that are different from recommendations previously made by panels under GATT and WTO practice. Canada submits, however, that the present dispute is very different from any other dispute settlement procedure conducted to date under the GATT or the WTO Agreement. Canada argued that its position was supported by two considerations. First, the SCM Agreement as a whole and the dispute settlement procedure in Article 4 are novel and unique in the WTO. Second, and more to the point, Article 4.7 - the grant of authority to the Panel to make recommendations - is also new and unique. It is, indeed, a "special or additional" procedure in the sense of Article 1.2 of the DSU. For this reason, previous GATT and WTO practice is of limited value as guidance in interpreting the remedy provisions of Article 4 - except perhaps to draw the *a contrario* conclusion that Article 4.7 should *not* be interpreted to mean the same thing as Article 19 of the DSU. Article 4.7 provides the Panel with the authority to recommend the *withdrawal* of a *subsidy*, and not simply, as Article 19 provides, to bring a subsidy *programme into conformity* with the SCM Agreement. As the authority of the Panel is significantly different from the authority reflected in the "overwhelming preponderance" of practice prior to the entry into force of the WTO Agreement, the Panel may exercise this novel authority in a way that would be different from prevailing GATT and WTO practice (emphasis in original).

V. ARGUMENTS PRESENTED BY THIRD PARTIES

A. EUROPEAN COMMUNITIES

5.1 The European Communities submits that although Brazil has stated that it does not contest the existence of a subsidy in this case, nor indeed that it is contingent upon export performance, it will nonetheless be essential for the Panel to precisely define the subsidy at issue. The European Communities asserts that this has implications for the analysis under Article 27.4 of the SCM Agreement and, if Brazil's measure should be considered contrary to Brazil's WTO obligations, for the action which will be required of Brazil to implement the Panel's recommendations. The European Communities further note that the approach taken by the Panel in this case will be an important precedent for the interpretation of Article 1 of the SCM Agreement in future cases.

5.2 The European Communities refer to Article 1 of the SCM Agreement which defines a subsidy as being a financial contribution by a government and which confers a benefit. The European Communities observes that payments by Brazil to effect interest rate equalization are made by means of zero-coupon bonds maturing on interest payment dates and being worth 3.8 per cent of the capital outstanding.

Canada, the European Communities submit, analyses the payments under these bonds as "financial contributions" of the kinds mentioned in subparagraph (i) or alternatively (iv) of Article 1.1(a)(1) of the SCM Agreement. The European Communities argue that Canada's analysis is incomplete, as it overlooks certain important considerations.

5.3 The European Communities submits that Canada does not identify the beneficiary of the subsidy in its legal analysis. The European Communities argues that the direct recipient of these payments will not necessarily be the purchaser – it will be the holder of the bonds on maturity, as it appears that the purchaser may "elect to pay instead a more commercial rate of interest to obtain a lump-sum reduction in the purchase price through the sale of the bonds in the market."

5.4 The European Communities submits that although Canada characterises PROEX payments as "outright grants whether received in a stream of payments or in a lump sum," it does not draw the consequences of these alternative "payments" for the case at hand. The European Communities submits that it is important to do so, as an analysis which considers that PROEX confers a series of subsidies in the form of payments over 15 years will result in different contributions to the total "levels of export subsides" in each year compared with an analysis which treats PROEX as an outright subsidy in the form of a lump sum payment. It will therefore affect Brazil's compliance with its obligations under Article 27.4 of the SCM Agreement to phase out its export subsidies and not increase their level. The two alternative analyses also have different consequences in the event of a Panel recommendation to Brazil to "withdraw" the measure and the subsidy under Article 4.7 of the SCM Agreement.

5.5 The European Communities submits that the key to clarifying this issue lies in carefully considering the notion of "financial contribution" in Article 1.1 of the SCM Agreement. While in Canada's analysis, this is assumed to mean "payments," the European Communities submits that Article 1.1(a) of the SCM Agreement deliberately permits a much broader interpretation. For example a "financial contribution" under Article 1.1(a)(1)(i) of the SCM Agreement may be not only a "transfer of funds" but also a "potential direct transfer of funds or liabilities." Also, the other items in the List make clear that payments need not be immediate but may be simply committed. The European Communities argues that given the facts of the case, the Brazilian government makes a financial contribution when it issues, or enters into a commitment to issue, bonds in support of an export transaction. The facts of this case show that the issue of these bonds has an immediately realisable value which supports the export sale. This is also the point in time when the ultimate and intended beneficiary, the Brazilian exporter, obtains its benefit by concluding an export sale, on the basis of the existence of a financial incentive without which the sale may not have taken place.

5.6 The European Communities considers that this interpretation is supported by a consideration of the context of Article 1 of the SCM Agreement, its object and purpose as well as general principles of law. The European Communities submit that the relevant elements of context and legal principles which the European Communities submit should guide the Panel are as follows:

- Article 4.7 of the SCM Agreement provides that a finding by the Panel that PROEX is a prohibited subsidy would require it to recommend "that the subsidy be withdrawn without delay" and to specify in its recommendation "the time period in which the measure must be withdrawn."

- One purpose of the dispute settlement system is to provide "security and predictability to the multilateral trading system" (Article 3.2 DSU). The same provision also provides that "recommendations and rulings of the DSB shall not add to or diminish rights and obligations provided for in the covered agreements." A corollary of this for the European Communities is that

the dispute settlement system cannot produce retroactive effects. Nothing in the SCM Agreement demonstrates a contrary intention.

- The WTO Agreements, like international law in general, lay down rights and obligations for the states and international organisations which are its Members. They do not create rights and obligations for private parties.

- It is a general principle of law that legitimate expectations should be protected.

5.7 The European Communities asserts that these elements of context and legal principles support its interpretation of Article 1.1 of the SCM Agreement. An interpretation of the SCM Agreement which would consider the *payments* under the bonds to constitute subsidies (rather than the fact of entering into a legal obligation to make such payments in support of an export sale) could also have as its result that a scheme could never be considered a subsidy until actual payments are made; this interpretation would unjustifiably limit the scope of Article 1 of the SCM Agreement (which specifically refers to "potential transfers of funds"). Moreover, such an approach would entail that, in case the Panel makes a finding against PROEX, Brazil would be required to withdraw the subsidy and therefore all subsidies not yet granted, i.e., payments could no longer be made under Brazilian government bonds or that a purchaser of EMBRAER aircraft would have to pay a higher price than that resulting from the contract. This would be extremely disruptive of the rights of private parties, purchasers, suppliers and banks. In addition, since in this case the payments are "tied" to specific contracts and made to a person other than the ultimate or intended beneficiary of the subsidy, such an interpretation could not contribute to removing the harm of any prohibited subsidy. It is therefore to be avoided in such a context.

5.8 The European Communities submits that a recommendation of the Panel to withdraw the subsidy based on the assumption that each payment made under a PROEX contract constituted a separate financial contribution would probably be impossible to implement. It would inevitably lead to countermeasures under Article 4.10 of the SCM Agreement.

5.9 The European Communities considers that this interpretation is particularly appropriate in the present case of an alleged prohibited subsidy in the aircraft sector in order to ensure a remedy consistent with the intention of the SCM Agreement and the general principles of international law. The remedy may not, of course, be the same in, for instance, countervailing duty cases, where there is a requirement to establish the existence of a quantifiable amount of subsidy. The European Communities submits that the issue of when the financial contribution is made and the benefit granted should not be confused with the issue of the appropriate timing and level of duties in a countervailing duty investigation; there, the investigating authorities aim to "capture" the benefit of the subsidy for the purpose of "offsetting" it through the imposition of countervailing duties and may therefore take into consideration the actual flow of cash as a reasonable basis for quantifying the benefit in any given investigation period.

5.10 The European Communities submits, based on the above analysis, that a financial contribution is made, and a benefit is conferred, when a binding commitment of PROEX support for an export-contingent sales contract is concluded. The European Communities is aware of the practice of concluding option contracts for the purchase of aircraft. These are of many different kinds and the application of the above principles to them will depend on their precise terms.

5.11 The European Communities submits that if it is considered that a financial contribution is made, and a benefit is conferred, when a binding commitment of PROEX support for an export-contingent sales contract is concluded, then it would not be feasible to require Brazil to "withdraw the subsidy" for contracts already concluded by EMBRAER with PROEX support, as demanded by Canada. There is no

basis in the Dispute Settlement Understanding or the SCM Agreement for the Panel to make a recommendation retroactive to 22 October 1998.

5.12 The European Communities confirms its view that the Brazilian government grants a subsidy when it "issues or enters into a commitment to issue bonds in support of an export transaction" in its response to the following question from the Panel: "The European Union argues that under Article 1 of the SCM Agreement, the Brazilian government grants a subsidy when it 'issues or enters into a commitment to issue bonds in support of an export transaction' as opposed to when the payments are actually made. Would such a finding limit the impact of a panel recommendation, as only future commitments with the support of PROEX would be affected? Would the view of the European Union be affected if a disproportionate number of contracts were concluded between the date of establishment of the panel and when the panel/Appellate Body report is adopted?"

> "PROEX payments, [which] are made to the lending financial institution in the form of non-interest bearing National Treasury Bonds, … may either be redeemed on a semi-annual basis for the duration of the financing period or may be sold on the market and the proceeds paid to the purchaser as a lump sum. This clearly demonstrates that the subsidy is granted at the moment the PROEX commitment is made by Brazil in connection with the binding purchase contract for an aircraft to which it is tied; the subsequent "use" of the subsidy is left to the discretion of the purchaser…As a result in these specific circumstances (contract-specific subsidies), a Panel recommendation cannot affect subsidies already granted without disrupting the rights of private parties, purchasers, suppliers and banks…[A] Panel recommendation in this case can only relate to definitive PROEX commitments made after the adoption of a Report by the Dispute Settlement Body. Accordingly, it will not apply to PROEX commitments made on aircraft sales contracts which are binding before the report is adopted…The European Communities realises that this position means that, if the Panel finds the PROEX subsidies to be prohibited, this will mean that there is no "remedy" against certain past subsidies. However, this is an unavoidable consequence of the present rules and must be accepted. Canada's potential remedy in the present case can only be to have the PROEX scheme modified or terminated for the future…The absence of remedy for past and consummated violations is a well-known feature of the GATT/WTO system. First, it is inherent in the principle that DSB rulings do not have retroactive effect. Second, it is established and accepted that it can lead in some cases to there being no remedy at all for the complaining party. [The decision]…of the Panel in *Norway - Procurement of Toll Collection Equipment for the City of Trondheim*[168],… [a case under the Agreement on Government Procurement] is still. pertinent…[There the Panel] did not consider it appropriate for it to recommend that Norway negotiate a mutually satisfactory solution with the United States that took into account the lost opportunities of the United States companies in the procurement or that, in the event that such a negotiation did not yield a mutually satisfactory result, the Committee be prepared to authorise the United States to withdraw benefits under the Agreement from Norway with respect to opportunities to bid of equal value to the Trondheim contract."

5.13 The European Communities disagrees with Brazil's *a contrario* interpretation of the item (k) of the Illustrative List. If this interpretation were to be accepted, it could change Annex I of the SCM Agreement from an illustrative to an exhaustive list of export subsidies. The European Communities submits that there is a clear contrast between the first and second paragraphs of item (k) of the Illustrative List. The first paragraph, the only one on which Brazil relies, declares to be an export subsidy certain measures "in so far as they are used to secure a material advantage in the field of export credit terms."

[168]*See*, GPR/DS.2/R, adopted on 13 May 1992, paras. 4.21, 4.24 and 4.26.

This defines the scope of the prohibition; it does not derogate from Article 3.1(a). The second paragraph provides that export credit practices within certain defined limits "shall not be considered an export subsidy prohibited by this Agreement." The second paragraph is covered by footnote 5; the first paragraph is not.

5.14 The European Communities submits that the OECD Guidelines on Officially Supported Export Credits clearly satisfy the requirements of paragraph 2 of item (k) of Annex I of the SCM Agreement. All export credit activities which conform to the OECD Guidelines, are not prohibited under Article 3.1 or any other provision of the SCM Agreement. Thus, for purposes of the SCM Agreement, paragraph 2 of item (k) of the SCM Agreement creates a "safe haven" for Member export credit practices which conform to the OECD Guidelines. The European Communities submits that the OECD guidelines place important restrictions on the ability of member countries to subsidise. Measures which effectively reduce rates below those of the Arrangement, fall outside the "safe haven" and are subject to the full rigours of the SCM Agreement. If they constitute a subsidy and are export contingent, they are prohibited.

5.15 In response to a question[169] from the Panel concerning the scope of item (k) of the Illustrative List of Export Subsidies, the European Communities reiterated its view that Brazil's interpretation of item (k) of the Illustrative List was unjustified and not supported by the text of the SCM Agreement:

> "[T]he first paragraph of Annex I(k) to the…[SCM Agreement should be seen] to be defining an *illustrative* prohibition (i.e., *not* exhaustively defining the scope of Article 3.1 (a) in this sector) and that the second paragraph by contrast contained an exception, not only from the first paragraph but from the whole…[SCM Agreement] (the OECD "safe haven")…Since the first paragraph contains an *illustrative prohibition*, it does not much matter whether the term "in the field of export credits" is limited to interest rates and transaction costs. The same prohibition would apply, if not under this paragraph, then under Article 3.1(a), to other elements of a transaction than interest rates and transaction costs that have the same effect as a subsidy (in other words, bringing the effective rate below the applicable Arrangement rate)…Of the two benchmarks proposed by the question, the first would lead to the whole of the PROEX being considered contrary to the first paragraph of item (k) since PROEX operates to reduce the commercial interest rate available to the transaction by 3.8 per cent. The second benchmark would lead to PROEX being contrary to that paragraph only when the commercial interest rate available to the transaction exceeds the OECD Arrangement by less than 3.8 per cent…The [European Communities] considers that the context of this paragraph (and in particular the second paragraph of item (k) which even more clearly reflects the intention that export credits should not distort competition) pleads in favour of the material advantage being assessed by comparison with the generally available or OECD arrangement rate."

5.16 The European Communities submits that while it recognises that subsidies may be important in the economic development of developing countries and does not wish to impose any new obligations on developing countries in this respect, Article 27.4 of the SCM Agreement should not be interpreted to exempt developing countries unconditionally from the disciplines of Article 3.1 of the SCM Agreement.

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[169]The question posed by the Panel was as follows: "It could be argued that the phrase "in the field of export credits" as used in item (k) of the Annex I of the SCM Agreement is limited to the interest rates and other transaction costs. Assuming for the sake of argument that this view is correct, what would be the appropriate benchmark for a comparison? Specifically, should the export credit terms of a transaction supported by PROEX interest rate equalization be compared to the export credit terms that would be available to that purchaser of EMBRAER aircraft on the market for the purchase of those aircraft if the PROEX interest rate equalization were not available for the transaction, or should it relate to the export credit terms available (including through official financing at OECD consensus rates by a Participant to the OECD Arrangement) to the purchaser if it purchased a competing aircraft".

Article 27.4 imposes a number of conditions which should be respected. These are that export subsidies shall be (a) phased out during this period, preferably in a progressive manner; (b) they should not be increased and (c) be eliminated earlier if the use of such export subsidies is inconsistent with the country's development needs. Since Article 27.4 is a conditional exception to a basic prohibition of the SCM Agreement, these conditions should be strictly adhered to if a developing country Member were to avail itself of the exemption provided by the Article.

5.17 With respect to the relationship between Articles 3 and 27 of the SCM Agreement, the European Communities in a response to questions from the Panel stated:

> "[There seems] to be no basis to consider that Article 27 is *lex specialis* to Article 3.1(a), as this term is normally understood. A *lex specialis* would contain a complete set of rules. Article 27 does not. It contains certain exceptions or derogations and the conditions for their application. The rules which apply where the conditions are not met, are not found in Article 27, but in other provisions of the Agreement…If the Panel were to agree with Brazil that Article 27 is *lex specialis*, the burden of proof would be borne by Canada. If, on the other hand, Article 27 is considered to be an exception, it would be for Brazil, as the party invoking the exception, to prove that the conditions of paragraph 4 are fulfilled. Since Article 27.4 is a conditional exception to a basic prohibition of the [SCM Agreement], these conditions should be strictly adhered to…[T]his conclusion is confirmed by the corresponding procedural exemption contained in Article 27.7. This is made subject to the same conditions as the substantive exception…Indeed, since the Parties agreed to the applicability of Article 4 of the [SCM Agreement], they have implicitly assumed that Article 27…is not *lex specialis*. Otherwise Brazil would presumably have objected to the application of the procedure in Article 4 of the [SCM Agreement], at least until such time as Canada had demonstrated that the conditions of paragraphs 2 to 5 of Article 27 were not fulfilled."

B. UNITED STATES

5.18 The **United States** submits that Brazil's claim that it could provide export subsidies to counter non-export credit subsidies offered by another Member has no basis in WTO law, neither is it supported by a standard *Vienna Convention* analysis. The United States claims that Brazil's approach is incorrect, and, perhaps recognising the weakness of its position, Brazil does not even argue that its approach is supported by such an analysis. The ordinary meaning of the phrase "to secure a material advantage in the field of export credit terms" does not support Brazil's position. The phrase refers to the "field of export credit terms" and not to the "field of subsidies in general." Moreover, the United States is not aware of anything in the context or object and purpose of the SCM Agreement that would warrant departing from the ordinary meaning of the phrase in question.

5.19 In a response to a question[170] from the Panel regarding which benchmark should be used to determine whether PROEX secures material advantage in the field of export credit terms, the United States stated that:

> "Within the context of the OECD Arrangement on Guidelines for Officially Supported Export Credits (the Arrangement), the provision of export credit terms outside the boundaries of the Arrangement is considered to imbalance the playing field (thereby generating the possibility of material advantage) and, therefore, to be subject to compensatory actions (e.g., matching). Hence, in the context of this question, the relevant reference point for comparison in evaluating

[170]The same question was posed to the European Communities; *ibid.*

the possible existence of material advantage are the terms available through the Arrangement (e.g., CIRR levels and repayment limits).

5.20 The United States submits that the following specific recommendations requested by Canada go far beyond the mandate of the Panel:

- Brazil shall not grant new subsidies under PROEX, including subsidies promised or committed, but not yet granted, on regional aircraft not yet delivered;

- Brazil shall no longer maintain existing subsidies under PROEX and must terminate such subsidies no later than three months after the adoption of the Report of the Panel by the DSB; and

- Brazil shall withdraw without delay PROEX subsidies granted pursuant to transactions entered into following the composition of the Panel on October 22, 1998.

The United States argues not only are they inconsistent with the express terms of Article 4.7 of the SCM Agreement, but also the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), and established GATT 1947 and WTO practice. Consequently, should the Panel agree with Canada on the merits, it should reject the requested remedies. The Panel should, instead, make a general recommendation that Brazil withdraw its PROEX subsidies without delay, and leave it to Brazil, in the first instance, to determine how such a withdrawal can best be accomplished. The United States notes, however, that under Article 4.7 of the SCM Agreement, the Panel also must specify the time period within which the subsidies must be withdrawn.

5.21 The United States argues that the specific recommendations[171] requested by Canada go far beyond the types of recommendations made by the overwhelming preponderance of prior GATT 1947 and WTO Panels. In virtually every case in which a Panel has found a measure to be inconsistent with a GATT obligation, Panels have issued the general recommendation that the country "bring its measures . . . into conformity with GATT."[172] This well-established practice is codified in Article 19.1 of the DSU, which provides: "Where a Panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement." Indeed, in the first case to work its way through the new dispute settlement system, the recommendations of both the Panel and the Appellate Body carefully adhered to Article 19.1.[173] Moreover, in the first WTO dispute to focus on the propriety of specific recommendations, the Panel found that Article 19.1 precluded such recommendations. In rejecting a request by Mexico for specific recommendations, the Panel in the *Guatemala - Cement* case stated:

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[171] By "specific" recommendation, the United States means a recommendation that requires a party to take a particular, specific action in order to cure a WTO-inconsistency found by a Panel.

[172] See, for example, *Canada - Measures Affecting Exports of Unprocessed Herring and Salmon*, L/6268, adopted 22 March 1988, BISD 35S/98, 115, para. 5.1. The United States noted that the number of panel reports in which panels have made recommendations using similar language is well in excess of 100.

[173] In its report on *United States - Standards for Reformulated and Conventional Gasoline*, adopted 20 May 1996, WT/DS2/AB/R, the Appellate Body recommended "that the Dispute Settlement Body request the United States to bring the baseline establishment rules contained in Part 80 of Title 40 of the Code of Federal Regulations into conformity with its obligations under the General Agreement." The Panel in that case issued a virtually identical recommendation. WT/DS2/R, para 8.2, adopted 20 May 1996.

> "In our view, this language clearly establishes a distinction between the **recommendation** of a Panel, and the **means** by which that recommendation is to be implemented. The former is governed by Article 19.1, and is limited to a particular form. The latter may be suggested by a Panel, but the choice of means is decided, in the first instance, by the Member concerned. Of course, it is possible that the prevailing Member in the dispute may not be satisfied with the Member's implementation. The DSU recognises this possibility, and provides for recourse to the dispute settlement procedures to resolve any such disagreements.[174] (emphasis in original)

5.22 The United States argues that the requirement that Panels make general recommendations reflects the purpose and role of dispute settlement in the WTO, and before it the GATT 1947. Article 3.4 of the DSU provides that "[r]ecommendations and rulings made by the DSB shall be aimed at achieving a satisfactory settlement of the matter," and Article 3.7 provides that "[a] solution mutually acceptable to the parties to a dispute . . . is clearly to be preferred." To this end, Article 11 of the DSU directs Panels to "consult regularly with the parties to the dispute and give them adequate opportunity to develop a mutually satisfactory solution." Ideally, a mutually agreed solution will be achieved before a Panel issues its report. However, if this does not occur, a general Panel recommendation that directs a party to conform with its obligations still leaves parties with the necessary room to cooperate in arriving at a mutually agreed solution. Indeed, a Member generally has many options available to it to bring a measure into conformity with its WTO obligations. A Panel cannot and should not prejudge by its recommendation the solution to be arrived at by the parties to the dispute after the DSB adopts the Panel's report.

5.23 The United States further notes that the requirement that panels issue general recommendations comports with the nature of a Panel's expertise, which lies in the interpretation of covered agreements. Panels generally lack expertise in the domestic law of a defending party.[175] Thus, while it is appropriate for a Panel to determine in a particular case that a Member's legislation was applied in a manner inconsistent with that country's obligations under a WTO agreement, it is not appropriate for a Panel to dictate which of the available options a party must take to bring its actions into conformity with its international obligations. The compliance process under the DSU makes the precise manner of implementation a matter to be determined in the first instance by the Member concerned, subject to limited rights to compensation or retaliation by parties that have successfully invoked the dispute settlement procedures. In Article 19 of the DSU, the drafters precluded a Panel from prejudging the outcome of this process in their recommendations.

5.24 The United States observes that the preceding analysis is not affected by the existence of Article 4.7 of the SCM Agreement, a provision which, pursuant to Article 1.2 and Appendix 2 of the DSU, is a special or additional rule and procedure. While Article 4.7 prescribes a recommendation (withdrawal of the subsidy) that is different from the recommendation prescribed in Article 19.1 of the DSU (bring the measure into conformity), there is nothing in the text, context, or object and purpose of Article 4.7 indicating that Panels have greater freedom in a prohibited subsidies dispute to dictate the means by which a subsidy is to be withdrawn. Indeed, the text of Article 4.7 suggests exactly the opposite. In Article 4.7, the drafters expressly granted Panels the authority to recommend the *timing* of withdrawal, but did not confer a similar express grant of authority on Panels to recommend the *means* of

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[174] *Guatemala - Anti-Dumping Investigation Regarding Portland Cement from Mexico,* WT/DS60/R, report of the Panel circulated on 19 June 1998, para. 8.3, reversed on other grounds, WT/DS60/AB/R, report of the Appellate Body adopted on 25 November 1998.

[175] See Article 8.3 of the DSU, which provides that citizens of Members whose governments are parties to a dispute normally shall not serve on a Panel concerned with that dispute, absent agreement by the parties.

withdrawal. This suggests that the drafters consciously refrained from granting Panels the authority to recommend, in the first instance, the means of withdrawal.

5.25 The United States submits that in the first subsidies case to work its way through the WTO dispute settlement system, the Panel declined to make a specific recommendation. In the *Indonesia - Autos* case, the United States and the European Communities alleged that subsidies provided by Indonesia caused serious prejudice to their respective interests.[176] Article 7.8 of the SCM Agreement, which is a special or additional rule and procedure under Article 1.2 and Appendix 2 of the DSU, essentially provides that where a complainant proves its case of serious prejudice, the subsidising Member "shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy." In *Indonesia - Autos*, the Panel found that the European Communities had proved its serious prejudice case, but declined to specify the means by which Indonesia had to eliminate the adverse effects or withdraw the subsidies.[177]

5.26 The United States submits that the issue as to when the Brazilian government grants a subsidy is not that "important" in this particular case. In a response to a question[178] posed by the Panel, it stated that:

> "The United States does not…contest [the argument of the European Communities regarding] the timing of this particular subsidy…[It] does not believe, [however], that the timing of the subsidy in this case is an important issue. Here, the United States simply notes that there is a difference between the "timing" and the "duration" of a subsidy. The timing of a subsidy deals with the question of how long a subsidy lasts, and would seem to be the more relevant issue for purposes of the instant dispute…[T]he United States does disagree with the [European Communities] regarding the conclusions to be drawn from this fact. More specifically, the United States does not believe that there is anything in the SCM Agreement in particular, or in public international law in general, that would preclude repayment of a subsidy by the recipient as one means of withdrawing a subsidy within the meaning of Article 4.7 of the SCM Agreement. The point made by the United States in its third-party submission was that it is not for the Panel to specify the means by which a subsidy is to be withdrawn. The United States agrees with the proposition that remedies in the WTO dispute settlement system are not retroactive. However, in the case of a subsidy that is properly allocated over several years (as appears to be the case with respect to PROEX subsidies in question), the withdrawal of that portion of the subsidy allocated to future time periods would not constitute a retroactive remedy or retroactive implementation. Instead, it would constitute prospective implementation based on a recognition of the distinction between the measure conferring a subsidy and the subsidy itself. In this regard, the…[European Communities] focuses on the timing of the subsidy, but ignores the duration of the subsidy. While a subsidy comes into existence at a particular point in time, the benefit of the subsidy can extend over a period of years, depending on the nature of the subsidy in question…[T]he argument that repayment (or a cessation of future payments on PROEX government bonds) would be disruptive to private parties proves too much. The United States submits that it is the rare case in which the behaviour of private parties is *not* disrupted when WTO dispute settlement results in a recommendation and ruling that a Member withdraw a measure on which private parties have come to rely or on which they have based their plans. Moreover, it is difficult to see how anyone, whether in the private or governmental sector, could have legitimate expectations regarding subsidies found to be prohibited by the WTO. The United States also sees no merit to

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[176] *Indonesia - Certain Measures Affecting the Automobile Industry*, WT/DS54/R, report of the Panel adopted 23 July 1998, paras. 3.3(e) and 3.4(h).

[177] *Id.*, paras. 15.3-15.4.

[178] The same question was posed to the European Communities: s*ee*, para. 5.12 of this report.

> the [European Communities] distinction between the remedy available in a WTO dispute and the remedy available in a countervailing duty case, and notes that the EU does not cite anything in the text of the SCM Agreement to support this distinction. Both types of cases provide a means for offsetting the artificial benefit bestowed on recipients of a subsidy. In a countervailing duty case, this takes the form of an offsetting duty (or an undertaking which, *inter alia*, may require the elimination of the subsidy). In a WTO dispute, the remedy may take the form of a withdrawal of the subsidy (and, thus, the benefit inherent in the subsidy). "

5.27 The United States further maintains that the interpretation of the European Communities would "eviscerate the utility of WTO dispute settlement as a vehicle for addressing trade distortive subsidies. As an example, assume that Country X provides a $1 billion grant to Company Y. The purpose of the grant is to allow Company Y to construct a facility that will produce widgets for export. A WTO panel finds that the grant is a prohibited subsidy, but at the time when the DSB adopts the panel report, Country X already has disbursed the $1 billion to Company Y and Company Y already has contracted for construction of the facility… as the United States understands the position of the [European Communities], the best remedy that could come from this case is that Country X could not provide another subsidy to Company Y. However, widgets produced by Company Y would continue to be subsidized by virtue of the $1 billion grant."

5.28 The United States submits that such a result would be absurd, which could neither be justified "by the terms of the SCM Agreement, the DSU, or public international law…[It] would render the increased disciplines of the SCM Agreement meaningless. Instead, the appropriate outcome would be a withdrawal of that portion of the $1 billion grant allocated to future time-period. How such a withdrawal would occur would depend on the domestic law of Country X. If a withdrawal was not permissible under the domestic law, then compensation or countermeasures would be appropriate".

5.29 In a response to a question from the Panel as to whether it agreed with the Brazilian argument that "because Article 27 is *lex specialis* to Article 3 of the SCM Agreement, Article 3 does not apply to developing countries. Therefore, it is not possible for developing countries to act in a manner inconsistent with Article 3", the United States stated that:

> "As a general matter, the United States does not see any basis for the above-quoted argument…Article 27.2(b), by its very terms, excuses a developing country Member, such as Brazil, from the prohibition in Article 3.1(a) *only if* it complies with Article 27.4. The United States disagrees with the proposition that the general legal principle of *lex specialis* (assuming it applies to this dispute at all), could override the plain text of a treaty."

Relying on the ruling of the Appellate Body in *United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India*[179], the United States was of the view that since "the relevant provisions of Article 27…[operated] as affirmative defences against the prohibition in Article 3.1(a), the initial burden of proof was on Brazil.

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[179] *Supra*, footnote 142.

VI. INTERIM REVIEW

6.1 On 25 February 1999 both parties submitted written requests for the Panel to review precise aspects of the interim report, and on 3 March 1999 each party submitted written comments regarding the other's request. Neither party requested a further meeting with the Panel.

6.2 Canada notes that, in paragraph 7.18 and in footnotes 194 and 195 of the interim report (footnotes 197 and 198 of this report) , we considered but failed to make findings on two legal issues related to Brazil's affirmative defense based on the first paragraph of item (k) of the Illustrative List of Export Subsidies. In Canada's view, the principle of judicial economy does not properly apply to these issues, and the Panel should have resolved them. Canada states that, as the Appellate Body observed in *Australia – Salmon*[180], the aim of dispute settlement, according to Article 3.7 of the DSU, is to "secure a positive solution to the dispute." Accordingly,

> "A Panel has to address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member with those recommendations and rulings...."[181]

6.3 Canada contends that Brazil has argued that the first paragraph of item (k) is an exception that provides cover for PROEX payments. As it stands, the Interim Report concludes that PROEX, an admitted export subsidy, is applied in such a way that it would not benefit from the "material advantage" clause of this item. The import of the Panel's findings is that Brazil could not bring PROEX payments into compliance by, for example, simply adjusting the *rate* of subsidization and then arguing that these payments no longer "secure a material advantage". Canada considers that the Panel should give this point greater precision by finding that the first paragraph of item (k) cannot be used as an exception at all, and that in any event, PROEX payments are not "payments" within the meaning of item (k).

6.4 In paragraph 7.18 of our interim report, we found that Brazil's "material advantage" defense under the first paragraph of item (k) could succeed only if Brazil prevailed on three legal issues. We concluded that PROEX payments were "used to secure a material advantage in the field of export credit terms", and declined to reach the other two legal issues presented with respect to that defense. In considering Canada's argument that we should address the remaining legal issues, we note that, in *Australia – Salmon*, the Appellate Body addressed the circumstances under which a panel might or might not address certain *claims* raised by a complainant. In this case, however, the question is whether we should have reached all legal *issues* related to a particular claim. In any event, Canada has not convinced us that, in this case, deciding the remaining legal issues would provide any further guidance with respect to compliance with the recommendations and rulings of the DSB. Thus, recalling that the purpose of the dispute settlement process is to "secure a positive solution to the dispute", and because in our view issues of legal interpretation are best addressed in concrete cases where they are necessary to resolve the case at hand, we decline to take up Canada's invitation to resolve the two legal issues in question.

6.5 Brazil argues that the appropriate time-period to withdraw the subsidy noted in paragraph 8.5 of the Report should be seven and one-half months. In Brazil's view, since Article 4.7 of the SCM Agreement does not specify a specific time-period, the time-period set forth in Article 21.3(c) of the DSU should be halved pursuant to Article 4.12 of the SCM Agreement. Brazil further contends that no evidence has been presented in this case to justify departing from the seven and one-half month guideline.

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[180] *Australia – Measures Affecting the Importation of Salmon*, WT/DS18/AB/R, Report of the Appellate Body adopted on 6 November 1998.

[181] *Id.*, para. 223.

Brazil further notes that PROEX was created by the Brazilian Congress, and that any changes therefore must also be enacted by Congress. It is therefore impracticable for Brazil to comply with the Panel's recommendation within 90 days. Finally, Brazil noted that the world financial crisis had had a significant and detrimental effect on Brazil. Brazil noted that, in *Indonesia – Autos*, the arbitrator allocated Indonesia an additional period of six months over and above the time required for the completion of its domestic rule-making process pursuant to Article 21.2 of the DSU.[182]

6.6 Canada responds that, at issue in this dispute is not the PROEX programme *as such*, but the way that programme is *applied* to the export sales of regional aircraft. Brazil can comply with the recommendation of the Panel simply by stopping the payment of such subsidies on exported regional aircraft delivered after the date of adoption of the Panel Report. Because neither the annulled PROEX legislation nor the monthly Presidential decrees that currently maintain the programme are mandatory, there is no legal requirement for Congressional action before the payment of PROEX export subsidies – that is, the issuance of NTN-1 bonds – on the delivery of exported aircraft is stopped. Canada further argues that Article 4.12 applies only to the "conduct of such disputes", not to implementation, and that the "reasonable period of time" standard set forth in Article 21.3(c) is not the benchmark of "without delay" for the purposes of Article 4.7 of the SCM Agreement. Finally, Canada argues that it is not apparent how Brazil's mention of its status as a developing country Member or mention of its current financial crisis in any way affects the period of time for compliance with the Panel's recommendation.

6.7 We decline Brazil's request to modify the time-period set forth in paragraph 8.5. Assuming that the time-period set forth in Article 21.3(c) of the DSU, as halved pursuant to Article 4.12 of the SCM Agreement, is applicable to disputes under Article 4 of the SCM Agreement -- an issue we do not decide – Article 21.3(c) of the DSU merely states that the "reasonable period of time" to implement panel or Appellate Body recommendations "should not exceed" 15 months. In this case, and reading that provision in conjunction with the requirement of Article 4.7 that the subsidy be withdrawn "without delay", we do not consider that a seven and one-half month time-period would be appropriate. We note that, while PROEX was created by legislation, it is currently maintained in force through Provisional Measures issued by the Brazilian government on a monthly basis. In any event, we recall Canada's view that implementation does not in the first instance require the modification of the PROEX interest rate equalization scheme itself, but merely a cessation in the issuance of new bonds upon exportation of Brazilian regional aircraft. Nor do we consider that, in the particular circumstances of this case, Article 21.2 of the DSU would warrant stretching the ordinary meaning of the phrase "without delay" to provide for an implementation period of seven and one-half months. Accordingly, we have not modified the time-period specified for withdrawal of the measure.

6.8 Canada states that it is implicit in our findings and conclusions that all of the conditions of Article 27 have to be met before a developing country Member may benefit from Article 27, and asks that we state this explicitly. We have modified paragraphs 7.57 and 8.1(c) in response to Canada's request. We have also clarified our findings through modifications to paragraphs 8.1(a), 8.1(b) and footnote 198. Finally, we have made other minor modifications of a typographical nature, including those in paragraphs 7.13, 7.30, 7.34, 7.53, 7.56, 7.68, 7.71, 7.72, 7.73, 7.75 and footnotes 198, 200, 215, 220, 231, and 241.

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[182] *Indonesia – Certain Measures Affecting the Automobile Industry*, Award of the Arbitrator, WT/DS64/15, WT/DS55/14, WT/DS59/13, WT/DS64/12, para. 24.

VII. FINDINGS

A. THE MEASURES AT ISSUE

7.1. In its request for establishment of a panel (WT/DS46/5), Canada asks that the Panel "consider and find that export subsidies under PROEX are inconsistent with Article 3 of the SCM Agreement." In its first submission to the Panel, Canada clarifies that "[a]t issue in this dispute is whether the *Programa de Financiamento ás Exportações* (PROEX) . . . confers export subsidies on sales of Brazilian regional aircraft that are prohibited under Article 3 of the . . . SCM Agreement"[183], and asks the Panel to find that "payments made under the 'Interest Equalization' component of PROEX on exported Brazilian regional aircraft" constitute prohibited subsidies.[184] In its second submission, Canada states that "the 'matter' subject to its request for a Panel was PROEX and the export subsidies paid under that programme to civil aircraft. This was the same 'prohibited subsidy' on which Canada had requested consultations."[185] A few paragraphs later, Canada states that "it is Canada's submission that export subsidies paid under PROEX, the Brazilian export subsidy programme, on all exported Brazilian regional aircraft, in whatever amount and regardless of the specific legislative instrument that underlies the programme, are prohibited by Article 3 and must be withdrawn. It is this practice that is the subject of Canada's challenge."[186]

7.2. We note that there is a certain lack of clarity regarding the precise measures being challenged by Canada. We do not understand Canada to be alleging that the interest rate equalization component of the PROEX programme *per se* is the prohibited measure, because Canada does not seek a finding or recommendation with respect to the programme itself.[187] In fact, it limits itself to challenging PROEX payments relating to the particular sector of regional aircraft.[188] On the other hand, neither is Canada restricting its challenge to a particular specified payment or payments already made pursuant to the interest rate equalization component of PROEX. To the contrary, although Canada identifies specific transactions with respect to which it considers that PROEX payments have been or will be made, Canada is arguing that all PROEX payments, to the extent they relate to exported Brazilian regional aircraft, *including payments to be made in the future pursuant to the PROEX interest rate equalization scheme,* are prohibited subsidies. Thus, we understand Canada to be challenging not only specific payments, but more generally the practice involving PROEX payments relating to exported Brazilian regional aircraft (which we will hereafter refer to as "PROEX payments"). In order to analyse this contention, we are required to go beyond an examination of individual PROEX payments that have been identified and look

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[183] Canada first submission, paragraph 1.

[184] Canada first submission, paragraph 2. Although Canada's request for establishment of a panel also identifies "export financing under PROEX", i.e., PROEX direct export financing, Canada states that it "does not challenge PROEX Financing in this dispute." Canada first submission, paragraph 30.

[185] Canada second submission, paragraph 19.

[186] Canada second submission, paragraph 23.

[187] Because we understand that Canada has not challenged the PROEX programme *per se*, we need not address the issue whether the PROEX programme may be subject to challenge under Article 4 of the SCM Agreement. We note however that in our view the effective operation of the SCM Agreement requires that a party be able in some manner to obtain prospective discipline on the provision of subsidies in cases where it can be established in advance, based upon the legal framework governing the provision of those subsidies, that they would be inconsistent with Article 3 of the SCM Agreement. Otherwise, the SCM Agreement's prohibitions could not be invoked until a particular prohibited subsidy had actually been paid. This would be tantamount to the proverbial closing of the barn door after the cows have gone.

[188] In its request for findings, Canada sometimes refers to "civil aircraft" and at other times refers to "regional aircraft". Judging from the totality of Canada's submissions, however, we conclude that Canada is challenging PROEX interest rate equalization payments only with respect to regional aircraft. Canada defines the regional aircraft market as consisting of commercial aircraft with 20-90 seats, whether turboprop or jet. On the basis of the evidence before us, it appears that three EMBRAER aircraft --the ERJ-145, the ERJ-135 and the EMB-120 -- fall within this definition.

more generally at the nature and operation of the PROEX interest rate equalization scheme which governs the payment of the alleged export subsidies.[189]

7.3. Because Canada is challenging not only specific PROEX payments relating to regional aircraft, but more generally the practice of providing PROEX payments, we do not and could not have before us a comprehensive list of the transactions supported by PROEX interest rate equalization which are challenged by Canada. We note however that Brazil has provided a list of post 1 January 1995 transactions supported by PROEX interest rate equalization relating to two Brazilian regional aircraft, the EMB-120 and the ERJ-145, and Canada has requested that we make specific findings regarding PROEX payments relating to these transactions. The transactions relating to the EMB-120 involve Great Lakes Airlines, Rio Sul, Skywest and "others", while those relating to the ERJ-145 involve American Eagle, British Regional, City Airlines, Continental Express, Luxair, Portugalia, Regional, Rio Sul, Siv Am, Trans States, Wexford and "other". Thus, the payments subject to challenge in this dispute include, but are not limited to, PROEX payments made or to be made with respect to the transactions identified above.

B. PRELIMINARY OBJECTION BY BRAZIL

7.4. Canada's request for establishment of a panel (WT/DS46/5) contains a list of provisional measures, laws, decrees and other legal instruments which govern the operation of the PROEX programme. Brazil objects to the Panel's consideration of certain of these "measures" on the grounds that they were enacted or implemented subsequent to the last consultations between the parties and, as a result, were not and could not have been the subject of consultations. Brazil contends that Article 6.2 of the DSU requires that consultations with respect to the specific measures at issue must have taken place in order for a measure to be within a panel's terms of reference. Brazil further argues that Article 4 of the DSU requires that parties consult regarding a matter before resorting to a panel with respect to that matter.

7.5. Canada acknowledges that the legal instruments in question did not exist at the time consultations were held and thus were not themselves the subject of consultations. It contends, however, that the "matter" referred to in Canada's request for establishment of a panel – the payment of export subsidies under PROEX – was the same prohibited subsidy with respect to which the parties held consultations, in the sense that that matter is directly connected to the prohibited subsidy subject to the consultations and flows directly from it. Canada further notes that the Provisional Measure underlying PROEX must be renewed every month, and that Brazil's argument, if accepted, would bar examination of PROEX by a WTO dispute settlement panel altogether.

7.6. The objections raised by Brazil present us with an issue regarding the relationship between the matter before a panel as defined by its terms of reference and the matter consulted upon. Specifically, we must consider whether and to what extent a panel is limited in its consideration of the matter identified in its terms of reference by the scope of the matter with respect to which consultations were held. In considering this question in this dispute, we must apply not only the relevant provisions of the DSU, but also the special or additional dispute settlement provisions found in Article 4.2 through 4.12 of the SCM Agreement, keeping in mind the injunction of Article 1.2 of the DSU that, "[t]o the extent there is a difference between the rules and procedures of the [DSU] and the special or additional rules and

[189] As discussed in the following section of these findings, there are a wide range of legislative and regulatory instruments which collectively govern the operation of the PROEX programme. As these provisions have changed over time, certain aspects of the operation of PROEX interest rate equalization have also changed. In assessing the consistency of PROEX payments with the SCM Agreement, we will examine the operation of the regime up to and as of the date of the request for establishment of a panel by Canada.

procedures set forth in Appendix 2, the special or additional rules and procedures in Appendix 2 shall prevail."

7.7. In examining this issue, we first recall that our terms of reference are the standard terms of reference provided for in Article 7.1 of the DSU. Under those terms of reference, we are required to examine the "matter referred to the DSB" by Canada in its request for establishment (WT/DS46/5). As the Appellate Body explained in *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*[190] "the '*matter* referred to the DSB', therefore, consists of two elements: the specific *measures* at issue and the *legal basis of the complaint* (or the *claims*)"(emphasis in original). The Appellate Body derived the meaning of the term "matter" in Article 7 of the DSU from Article 6.2 of the DSU, which requires that a request for establishment of a panel "identify the specific measures at issue and provide a brief summary of the legal basis of the complaint…." In this case, the measures alleged by Canada in its request for establishment of a panel to be inconsistent with the SCM Agreement are "export subsidies under PROEX." Thus, although Canada in its request for establishment of a panel identifies a list of legal instruments which it refers to as "measures", Canada is not, in our view, alleging that each of these legal instruments separately represents a measure inconsistent with Article 3 of the SCM Agreement. Rather, the legal instruments identified by Canada taken collectively represent a list of legal instruments relating to the payment of the alleged export subsidies under the PROEX scheme.

7.8. Turning next to Canada's request for consultations, we note that Article 4.4 of the DSU requires that a request for consultations "give the reasons for the request, including identification of the measures at issue and an indication of the legal basis for the complaint." Article 4.2 of the SCM Agreement requires a statement of available evidence with regard to "the existence and nature of the subsidy in question" and Article 4.3 of the SCM Agreement requires the Member "granting or maintaining the subsidy in question" to enter into consultations as quickly a possible. In this case, Canada requested consultations "regarding certain export subsidies granted under the Brazilian *Programa de Financiamento ás Exportações* (PROEX) to foreign purchasers of Brazil's EMBRAER aircraft." Thus, it is clear to us that the request for consultations related to the same general subject as the request for establishment of a panel, i.e., "export subsidies under PROEX". The request for consultations does not, however, identify the particular legal instruments which Brazil contends that we should not consider, nor could it have, because those particular legal instruments did not exist at the time the request for consultations was made. In fact, it is clear that the PROEX regime (and thus potentially the attributes of the PROEX payments under it) has changed over time, and that between the date the last consultations were held and the date that establishment of a panel was requested, some such changes occurred.

7.9. We recall that our terms of reference are based upon Canada's request for establishment of a panel, and not upon Canada's request for consultations. These terms of reference were established by the DSB pursuant to Article 7.1 of the DSU and establish the parameters for our work.[191] Nothing in the text of the DSU or Article 4 of the SCM Agreement provides that the scope of a panel's work is governed by the scope of prior consultations. Nor do we consider that we should seek to somehow imply such a requirement into the WTO Agreement. One purpose of consultations, as set forth in Article 4.3 of the SCM Agreement, is to "clarify the facts of the situation",[192] and it can be expected that information obtained during the course of consultations may enable the complainant to focus the scope of the matter

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[190] Adopted 25 November 1998, WT/DS60/AB/R, para. 72.

[191] *See, e.g., India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, adopted 16 January 1998, WT/DS50/AB/R, para. 92 ("The jurisdiction of a panel is established by that Panel's terms of reference, which are governed by Article 7 of the DSU.").

[192] As the Appellate Body has noted, "the claims that are made and the facts that are established during consultations do much to shape the substance and the scope of subsequent panel proceedings." *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, adopted 16 January 1998, WT/DS50/AB/R, para. 94.

with respect to which it seeks establishment of a panel. Thus, to limit the scope of the panel proceedings to the identical matter with respect to which consultations were held could undermine the effectiveness of the panel process.

7.10. We do not believe, however, that the question of consultations is completely outside our consideration. A party is not entitled to request establishment of a panel unless consultations have been held. Specifically, Article 4.7 of the DSU provides that a complaining party may request establishment of a panel only if "consultations fail to settle a dispute". Similarly, Article 4.4 of the SCM Agreement allows a "matter" to be referred to the DSB for establishment of a panel only if consultations have failed to lead to a mutually agreed solution. Given that Article 6.1 of the DSU and Article 4.4 of the SCM Agreement essentially require the DSB to establish a panel automatically upon request of a party, a panel cannot rely upon the DSB to ascertain that requisite consultations have been held and to establish a panel only in those cases.[193] Accordingly, we consider that a panel may consider whether consultations have been held with respect to a "dispute", and that a preliminary objection may properly be sustained if a party can establish that the required consultations had not been held with respect to a dispute. We do not believe, however, that either Article 4.7 of the DSU or Article 4.4 of the SCM Agreement requires a precise identity between the matter with respect to which consultations were held and that with respect to which establishment of a panel was requested.

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

C. ARE PROEX INTEREST RATE EQUALIZATION PAYMENTS EXPORT SUBSIDIES?

7.12. Canada argues that PROEX payments are subsidies within the meaning of Article 1 of the SCM Agreement which are contingent upon export performance within the meaning of Article 3.1(a) of that Agreement. Specifically, Canada contends that PROEX payments are financial contributions in the form either of a direct transfer of funds (a grant) within the meaning of Article 1.1(a)(1)(i) or an "indirect financial contribution" through a funding mechanism or a private body in the sense of Article 1.1(a)(1)(iv) of the SCM Agreement. Canada further contends that this "financial contribution" confers a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement in as much as it reduces the interest rate paid by purchasers of exported Brazilian regional aircraft by up to 3.8 percentage points. Finally, Canada asserts that PROEX payments are contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement in as much as they are available only with respect to the financing

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[193] As stated by the Appellate Body in a somewhat different context in *European Communities – Regime for the Importation, Sale and Distribution of Bananas,* adopted 25 September 1997, WT/DS27/AB/R, para. 142:

> "We recognize that a panel request will usually be approved automatically at the DSB meeting following the meeting at which the request first appears on the DSB's agenda. As a panel request is normally not subjected to detailed scrutiny by the DSB, it is incumbent upon a panel to examine the request for the establishment of the panel carefully to ensure its compliance with both the letter and the spirit of Article 6.2 of the DSU."

of export shipments. In its first submission, Brazil stated that it "does not dispute the assertion that PROEX interest equalization payments for aircraft constitute an export subsidy."[194] In response to a question from the Panel, Brazil reaffirmed that it "has not denied that PROEX interest rate equalization payments for aircraft fulfill the definition of a subsidy within the meaning of Article 1 and are contingent upon export within the meaning of Article 3.1(a)."[195]

7.13. As noted above, the parties agree that PROEX payments are subsidies within the meaning of Article 1 of the SCM Agreement which are contingent upon exportation within the meaning of Article 3.1(a) of the Agreement, and we agree with them. Although the parties disagree about the form of the financial contribution involved – with Canada arguing that they involve a direct transfer of funds, and Brazil adopting the European Communities' view that they also involve a potential direct transfer of funds provided at an earlier moment in time – we consider that the issue presented relates to the question as to when the subsidies in question are paid and not as to whether they exist. We note that, according to Article 1:1(i) a subsidy exists if a government practice involves a direct transfer of funds or a potential direct transfer of funds and not only when a government actually effectuates such a transfer or potential transfer (otherwise the text of (i) would read: "a government directly transfers funds … or engages in potential direct transfers of funds or liabilities"). The PROEX interest rate equalization scheme for aircraft fulfils the definition of a subsidy because there is a government practice, whether it involves a direct transfer of funds -- as Canada believes -- or a potential direct transfer of funds – as Brazil believes. As soon as there is such a practice, a subsidy exists, and the question whether the practice involves a direct transfer of funds or a potential direct transfer of funds is not relevant to the existence of a subsidy. One or the other is sufficient. If subsidies were deemed to exist only once a direct or potential direct transfer of funds had actually been effectuated, the Agreement would be rendered totally ineffective and even the typical WTO remedy (i.e. the cessation of the violation) would not be possible. We, therefore, consider that, the parties having agreed that PROEX payments are subsidies, the question of the form of financial contribution relates to the question of when the subsidy is paid, not when it comes into existence. This issue is taken up in section E.3. of these findings, where we consider whether Brazil has increased the level of its export subsidies.

7.14. For the foregoing reasons, we conclude that PROEX payments on exports of Brazilian regional aircraft are subsidies within the meaning of Article 1 of the SCM Agreement which are contingent upon export performance within the meaning of Article 3.1(a) of that Agreement.

D. ARE PROEX INTEREST RATE EQUALIZATION PAYMENTS "PERMITTED" BY ITEM (K) OF THE ILLUSTRATIVE LIST OF EXPORT SUBSIDIES?

7.15. We have found -- and Brazil does not dispute -- that PROEX payments are subsidies within the meaning of Article 1 of the SCM Agreement which are contingent upon export performance within the meaning of Article 3.1(a). Brazil does *not* concede, however, that these export subsidies are prohibited subsidies. Rather, Brazil contends that, although PROEX payments are export subsidies, they are nevertheless permitted by item (k) of the Illustrative List of Export Subsidies. Specifically, Brazil asserts that PROEX payments are the "payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits" within the meaning of item (k). Brazil further argues that,

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[194] Brazil first submission, para. 6.1.

[195] The question asked by the Panel was: "Brazil stated in its first submission (para. 6.1) that it 'does not dispute the assertion that PROEX equalization payments for aircraft constitute an export subsidy.' Without prejudice to your material advantage defense under item (k) of the Illustrative List, do you acknowledge that PROEX payments otherwise fulfill the definition of a subsidy within the meaning of Article 1 which is contingent upon export performance within the meaning of Article 3.1(a)? If not, please identify precisely all elements of Articles 1 and 3 you consider are not satisfied and a detailed explanation of your views with regard to those elements."

pursuant to item (k), such payments are prohibited only "in so far as they are used to secure a material advantage in the field of export credit terms", and that *a contrario* "such payments are *permitted* in so far as they are *not* used to secure a material advantage in the field of export credit terms." Finally, Brazil argues that PROEX payments are not used to secure a material advantage in the field of export credit terms, because they are merely used to offset "Brazil risk" and Canada's subsidies to Bombardier. Accordingly, Brazil concludes that PROEX payments are permitted by the SCM Agreement.

7.16. Canada contests Brazil's arguments on a number of grounds. First, Canada disputes Brazil's view that the first paragraph of item (k) may be used to establish that a measure is "permitted" by the SCM Agreement. It is Canada's view – strongly supported by the European Communities as third party -- that footnote 5 to the SCM Agreement, which states that "[m]easures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement", constitutes the only basis for arguing on the basis of the Illustrative List of Export Subsidies that a measure that does not fall within the scope of the Illustrative List is not prohibited, and Canada considers that the first paragraph of item (k) does not fall within the scope of that footnote. Second, Canada rejects Brazil's view that PROEX payments are the "payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits". Finally, Canada both disagrees with Brazil's interpretation of the "material advantage" clause in the first paragraph of item (k) and contends that PROEX payments are in fact "used to secure a material advantage" within the meaning of item (k).

7.17. In reviewing Brazil's item (k) defense, we note that in order for this Panel to rule in favour of Brazil we must find for Brazil on all of the following points. First, we must find that PROEX payments are the "payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits" within the meaning of item (k). Second, we must find that PROEX payments are not "used to secure a material advantage in the field of export credit terms" within the meaning of item (k). Finally, we must find that a "payment" within the meaning of item (k) which is not "used to secure a material advantage in the field of export credit terms" is "permitted" by the SCM Agreement even though it is a subsidy within the meaning of Article 1 of the SCM Agreement which is contingent upon export performance within the meaning of Article 3.1(a) of that Agreement. If we were to find against Brazil on any of these points, Brazil's item (k) defense would fail. Finally, we note Brazil's explicit acknowledgement that "its view of the 'material advantage' clause is that it constitutes an affirmative defense and, therefore, the burden of establishing entitlement to it is on the challenged party."[196]

7.18. It is by no means clear to us that it is permissible to use the first paragraph of item (k) as the basis for an *a contrario* argument as asserted by Brazil,[197] or that PROEX payments in fact constitute the "payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits".[198] Even assuming for the sake of argument, however, that Brazil is correct with

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[196] Brazil answer to panel question 41. *See United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, p. 16, adopted 23 May 1997 ("It is only reasonable that the burden of establishing [an affirmative] defence should rest on the party asserting it.").

[197] Footnote 5 to the SCM Agreement states that "[m]easures referred to in Annex I as not constituting export subsidies shall not be prohibited under [Article 3.1(a)] or any other provision of this Agreement." The only measures in the Illustrative List that are explicitly "referred to . . . as not constituting export subsidies" are export credit practices in conformity with the interest rate provisions of the Arrangement under the second paragraph of item (k). There are also a number of other cases, cited by Canada, where the Illustrative List affirmatively provides that a measure is not prohibited -- at least by that item -- or is permissible. The first paragraph of item (k), however, does not contain any such affirmative language, and would not appear to fall within the scope of footnote 5. Thus, a strong argument can be made that footnote 5 -- together with footnote 1 -- define the extent to which the Illustrative List can be used to establish that a measure is a "permitted" subsidy or, in the case of footnote 1, is not a subsidy at all. In light of our findings with respect to "material advantage", however, we need not decide this question.

[198] PROEX payments relating to export of Brazilian regional aircraft are provided in support of buyers' credits, i.e., export credits are extended to the foreign purchaser rather than to EMBRAER. Brazil's theory appears to be that lenders

respect to these two points, we consider Brazil's interpretation of the "material advantage" clause of item (k) is incorrect, and that, under a proper interpretation of that clause, Brazil has not demonstrated that PROEX interest rate equalization payments do not confer a material advantage in the field of export credit terms. As noted above, Brazil's "item (k)" defense can succeed only if Brazil prevails on all three legal issues. Because we dispose of Brazil's defense on the issue of whether PROEX interest rate equalization payments have been demonstrated not to confer a "material advantage", we need not decide whether Brazil's arguments on the first two issues are correct.

7.19. It will be recalled that, under item (k) of the Illustrative List, the following is an export subsidy:

> "The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed . . . , *or 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).

Assuming for the sake of argument that PROEX payments are payments within the meaning of item (k), the question presented in this dispute is the benchmark that should be used in determining whether such payments are in fact "used to secure a material advantage." In Brazil's view, the proper benchmark for determining whether PROEX payments are "used to secure a material advantage in the field of export credit terms" is to compare the export credit terms of transactions supported by PROEX payments with the export credit terms available to purchasers of *Canadian* regional aircraft. As stated in the Finan Report, "Material advantage in the field of export credit terms cannot be measured by evaluating just one country's subsidy benefits. Rather, determining material advantage requires evaluating one country's set of export credit terms relative to another country's set by applying a consistent methodology appropriate under the facts and circumstances."[199]

7.20. Brazil considers that, as a result of several factors, PROEX payments do not result in export credit terms for purchasers of *Brazilian* regional aircraft which secure a material advantage --i.e., are more favourable -- than the export credit terms available for purchasers of *Canadian* regional aircraft:

> "The concept of material advantage, as noted above, includes comparison – advantage vis-à-vis someone or something. Two points of comparison are relevant to the determination in this dispute of whether PROEX is used by Brazil to secure a material advantage in the field of export credit terms: (1) Brazil risk and (2) Canada's subsidies to Bombardier. On either measure alone, PROEX provides no material advantage. When

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providing export credits must borrow funds in order to finance their lending, that the export credits so funded are provided at below the lenders' cost of borrowing, and that PROEX payments are provided to compensate the lenders for this difference. In Brazil's view, this difference between the lender's cost of borrowing and the rate it charges for the export credits extended to purchasers therefore represents a "cost incurred by . . . financial institutions in obtaining credits." In addition, Brazil seeks to demonstrate that, although EMBRAER itself does not extend export credits to its customers, EMBRAER incurred certain costs in relation to the provision of buyer's credits to purchasers of Brazilian regional aircraft. Because our findings on the issue of "material advantage" dispose of Brazil's item (k) defense, we need not decide whether Brazil's view on this issue is correct. We note in passing, however, that -- assuming lenders providing export credits supported by PROEX payments are in fact providing export credits at below their cost of funds -- it is highly questionable whether that represents a cost for the lenders in "*obtaining* credits" as opposed to a cost incurred in *providing* credits.

[199] p. 1.9.

> the two are considered together, it is clear that it is Canada's programmes, not Brazil's, that are used to secure a material advantage."[200]

7.21. Turning to the first "point of comparison" proposed by Brazil, Brazil argues that PROEX payments do no more than offset "Brazil risk". Specifically, Brazil contends that, due to the high level of risk perceived by international markets with respect to Brazilian borrowers, the cost to EMBRAER and to Brazilian financial institutions of raising funds to finance exports of Brazilian regional aircraft is higher than the cost to Bombardier and Canadian financial institutions of raising funds to finance exports of Canadian regional aircraft. Because PROEX payments merely offset in part that higher cost of funds, allowing export credit financing for Brazilian regional aircraft on terms that are closer to, but still less favourable than, those available for competing Canadian regional aircraft, those payments are not in Brazil's view used to secure a material advantage in the field of export credit terms.

7.22. With respect to the second "point of comparison", Brazil contends that "material advantage should be determined by comparison of the total subsidy packages" available to competing regional aircraft. In support of this view, Brazil argues that "the field of export credit terms" includes not only the interest rate and duration of the financing but also the price of the aircraft being financed. Brazil contends that Canada provides a wide range of "direct and indirect subsidies" for Canadian regional aircraft, and that these subsidies reduce the price of Canadian regional aircraft, the cost of credit to purchasers or other "export credit terms." Brazil concludes that, because PROEX payments do not fully offset these subsidies, those payments are not "used to secure a material advantage in the field of export credit terms".

7.23. As can be seen from the above arguments, Brazil's material advantage defense is based upon the principle that a consideration whether an item (k) payment "is used to secure a material advantage in the field of export credit terms" involves a comparison between the export credit terms of the transaction supported by the payment and the export credit terms of potential competing transactions. We do not agree. We note the definition of "advantage" in *Webster's New International Dictionary of the English Language*, cited by Brazil, as "a more favorable or improved position". Similarly, the *Shorter Oxford English Dictionary* defines "advantage" as "superior position". Thus, we concur with Brazil that the term "advantage" involves the concept of comparison. In our view, however, nothing in the text of the first paragraph of item (k) indicates that the examination of material advantage involves a comparison *with the export credit terms available with respect to competing products from other Members*. To the contrary, we consider that, in its ordinary meaning, a payment is "used to secure a material advantage in the field of export credit terms" where the payment is used to secure export credit terms that are materially more favorable than the terms that would have been available in the absence of the payment. Accordingly, we consider that an item (k) payment is "used to secure a material advantage" where the payment has resulted in the availability of export credit on terms which are more favourable than the terms that would otherwise be available in the marketplace to the purchaser with respect to the transaction in question.

7.24. Our understanding of the meaning of the "material advantage" clause is supported by its context in the SCM Agreement. Brazil's approach to determining whether an item (k) payment is used to secure a material advantage and thus represents an export subsidy differs strikingly from that applied elsewhere in the SCM Agreement with respect to determining whether a measure is a subsidy generally, or an export subsidy specifically. In this respect, the Agreement does not focus on the conditions under which a competing product from another Member is being sold and exported. Rather, the general approach of the SCM Agreement to determining whether a measure is a subsidy and thus subject to discipline is whether the measure confers a "benefit" within the meaning of Article 1. Although the concept of benefit is not defined in the SCM Agreement, its application in various circumstances suggests that one should examine

[200] Brazil first submission, para. 6.6.

objective benchmarks, whether involving a comparison of the terms of the financial contribution to a market benchmark reflecting the terms under which the beneficiary of the financial contribution would be operating in the absence of the government financial contribution (as provided for in the calculation of the amount of the subsidy in terms of benefit to the recipient in a countervailing duty context under Article 14 of the Agreement)[201] or the existence of a cost to the government in providing the financial contribution (as envisioned by Annex IV relating to the calculation of the *ad valorem* subsidization for the purposes of the presumption of serious prejudice under Article 6.1(a) of the Agreement). In no case is it suggested that whether or not a benefit exists would depend upon a comparison with advantages available to a competing product from another Member.

7.25. Nor can we find any suggestion in either Article 3.1(a) of the SCM Agreement or the Illustrative List of Export Subsidies that whether a measure is a prohibited export subsidy should depend upon whether the measure merely offsets advantages bestowed on competing products from another Member. For example, item (c) of the Illustrative List treats as an export subsidy internal transport or freight charges on export shipments "on terms more favourable than for domestic shipments", irrespective of whether those charges are higher, lower or equal to the charges paid with respect to the shipments of competing products from other Members. Item (d) of the Illustrative List treats the provision of goods or services by a government for use in the production of exported goods as a prohibited export subsidy if the terms and conditions on which the goods or services are provided are more favourable than for the provision of goods for use in the production of goods for domestic consumption and if those terms and conditions are "more favourable than those commercially available on world markets *to their exporters*" (emphasis added). This last example is instructive, as the relevant test involves a comparison of the terms and conditions of the goods or services being provided by the government with the terms and conditions that would otherwise be available *to the exporters receiving the alleged export subsidy*; the fact that a foreign competitor had access to the same goods or services on better terms than those available to the exporters in question would not be a defense. In items (e), (f), (g), (h) and (i) of the Illustrative List, all of which relate to exemptions, remissions or deferrals of taxes or import charges, there is no hint that a tax advantage would not constitute an export subsidy simply because it reduced the exporter's tax burden to a level comparable to that of foreign competitors. In short, in asking us to look at the relative position of competitors in determining the disciplines applicable to item (k) payments, Brazil is asking us to construe that "material advantage" clause in a manner which does not conform to the general approach of the SCM Agreement.

7.26. In essence, Brazil's approach to "material advantage" boils down to an argument that an admitted export subsidy should not be deemed to be prohibited if it can be demonstrated merely to offset some advantage or advantages available to the competing product of another Member. We consider that such an interpretation would produce results that would be contrary to the object and purpose of the SCM Agreement. In our view, the object and purpose of the SCM Agreement is to impose multilateral disciplines on subsidies which distort international trade. It is for this reason that the SCM Agreement prohibits two categories of subsidies -- subsidies contingent upon exportation and upon the use of domestic over imported goods -- that are specifically designed to affect trade. The Brazilian approach to item (k), however, would effectively allow a Member to raise the provision of export subsidies --or indeed of any subsidy -- by the complaining Member as a defense justifying its own provision of export subsidies. This would entail a race to the bottom, as each WTO Member sought to justify the provision of

[201] The example of loans under Article 14 is instructive. Under Article 14(b), "a loan by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the loan pays on the government loan and the amount the firm would pay on a comparable commercial loan which the firm could actually obtain on the market." In other words, the relevant question is whether, as a result of the government intervention, the firm receiving the loan is better off than if that same firm had been required to obtain a loan in the marketplace.

export subsidies on the grounds that other Members were doing the same. Further, it should be recalled that under Articles 27 and 29 of the SCM Agreement certain Members are entitled to special and differential treatment and are not subject to the prohibition on export subsidies. It may be queried whether, if we were to interpret item (k) in the manner suggested by Brazil, developed country Members would in effect be authorized to match the export credit terms, however favourable, offered by developing country Members without falling afoul of the SCM Agreement's prohibition on the provision of export subsidies, with its consequent weakening of the SCM Agreement's disciplines on export subsidies. Such results certainly would not be consistent with the object and purpose of the Agreement identified above.

7.27. Finally, Brazil's interpretation of the material advantage clause would in our view generate results that are manifestly unreasonable in the context of the SCM Agreement. First, under Brazil's interpretation the determination whether an item (k) payment represented an export subsidy would require in each case an examination of the terms and conditions of the export credits available for competing products of another Member. Thus, a Member seeking to determine whether it could provide item (k) payments without violating Article 3 of the SCM Agreement would be required to first assess the terms and conditions under which export credits were available with respect to the competing products of all other Members. This might well prove impossible, given that the terms and conditions of a given export credit transaction are confidential business information not generally available to the public at large. Second, a payment could be found to be a prohibited export subsidy when challenged by one complainant yet found not to be a prohibited export subsidy when challenged by a different complainant whose exporters had access to export credit on more favourable terms, thus generating inconsistent results under the WTO dispute settlement system. Third, export subsidies that were "permitted" at a given moment might be transformed into prohibited export subsidies as a result of changes in the terms and conditions under which export credits were available in other Members.[202] We consider that an interpretation of item (k) that would make the status of a Member's measures as a possible export subsidy dependent on factors outside its knowledge and control, and that could generate such unpredictable results, is unreasonable and thus to be avoided.

7.28. Even if we were to agree with Brazil – which we do not -- that in order to ascertain whether an item (k) payment secures a material advantage it is necessary to examine the export credit terms available with respect to competing products exported from other Members, we still could not agree with Brazil's interpretation of the clause "in the field of export credit terms". It will be recalled that Brazil's interpretation of that clause would include as an export credit term the price at which a product was sold, and would therefore allow Brazil to offset through item (k) payments all subsidies provided to Bombardier that could reduce the price at which regional aircraft exported by that manufacturer could be sold and thus reduce the amount of the transaction to be financed. In our view, this interpretation stretches far beyond the ordinary meaning of the phrase in question. In its ordinary meaning, the field of export credit terms would refer to items directly related to export credits, such as interest rates, grace periods, transaction costs, maturities and the like. We consider that this interpretation is supported contextually by item (k) itself, which refers to a loan's "maturity and other credit terms". We 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.[203]

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[202] In response to a question from the Panel, Brazil acknowledges this, stating that "[i]t is true that under Brazil's theory, a permitted subsidy could become prohibited and vice versa depending on the action of other Members, but, Brazil submits, this is a logical consequence of the ordinary meaning of the language of item (k)."

[203] We recognize that there might be cases where an item (k) payment, rather than being used to reduce the interest rate or improve some other term related to the transaction, is applied to reduce the amount of the transaction financed. In fact, evidence on the record suggests that PROEX payments are sometimes used in precisely this manner, in that the financial institution providing the export credits, rather than using the PROEX payments to reduce the interest rate charged to the purchaser of an EMBRAER regional aircraft, may also sell the NTN-1 bonds it receives from the Government of Brazil in the

7.29. Brazil's arguments regarding the meaning of the "material advantage" clause seek to characterize its interpretation of that clause as necessary to protect the rights of developing country Members. Brazil's argument, if we understand it correctly, is that developed country Members have negotiated for themselves, in the second paragraph of item (k), a special safe haven from the export subsidy prohibition for export credit practices that conform to the interest rate provisions of the OECD Arrangement on Guidelines for Officially Supported Export Credits ("the OECD Arrangement"). Because of their high sovereign risk premiums, however, most developing country Members cannot afford to borrow on international capital markets at high rates of interest in order to engage in direct financing on terms consistent with the Arrangement. Under the first paragraph of item (k), however, developing country Members may – if Brazil's interpretation of "material advantage" is accepted – effect a reduction in the interest rates charged by financial institutions on export credits for their exports by making item (k) payments, at a lower cost than were the developing country Member to provide export credits directly at the same interest rates. Accordingly, and in Brazil's words, developing country Members "bargained . . . for the 'material advantage' language of item (k) precisely because, when Article 27's protection expires, they needed something they could afford in view of the fact that developed countries had their own self-designed exemption, which is presently in the second paragraph of item (k)."

7.30. We find Brazil's effort to characterize the interpretation of the first paragraph of item (k) as a developed/developing country issue unconvincing. First, we note that the "material advantage" clause has it origins in the Tokyo Round Subsidies Code[204] and was carried over unchanged into the SCM Agreement. Given that developing country signatories of the Code were exempted by Article 14.2 of the Code from the commitment not to grant export subsidies on products other than certain primary products, it seems unlikely that the material advantage clause was conceived at that time as a protection for developing countries. Nor has Brazil submitted any substantial support for the proposition that developing country Members sought to retain the "material advantage" clause during the Uruguay Round in order to retain the ability to offset the high sovereign risk of developing country Members through item (k) payments.[205]

7.31. Second, we believe that Brazil is incorrect in its underlying assumption that the second paragraph of item (k) provides a safe haven only with respect to direct export credit financing. The second paragraph of item (k) provides that "an export credit practice", whether of an Arrangement Participant or of a non-Arrangement WTO Member, which is in conformity with the "interest rate provisions" of the OECD Arrangement shall not be considered an export subsidy prohibited by the SCM Agreement. Chapter I:2 of the OECD Arrangement, titled "Scope of Application", provides that the Arrangement

market and use the proceeds to provide a cash discount to the purchaser. We do not preclude that, in such a particular situation, the field of export credit terms might be deemed to include the price of the goods being financed. This is a far cry, however, from the broad argument made by Brazil.

[204] Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade.

[205] In response to a question from the Panel, Brazil argues that a proposal during the Uruguay Round by "a developed country" to modify the first paragraph of item (k) by, *inter alia,* deleting the material advantage clause was rejected by Brazil and other developing countries. The informal negotiating document submitted by Brazil in relation to this answer tells us little about the issues before this Panel, however. First, the document in question says nothing about which countries made and which countries rejected the proposal. More importantly, the proposal not only would have deleted the "material advantage" clause, but would also have changed the benchmark for when direct export financing constitutes an export subsidy from a cost of borrowing standard to a market benchmark ("terms and conditions more favourable than the terms and conditions the borrower would otherwise obtain for financing comparable transactions"). An accompanying note focuses on the latter issue, and provides no explanation as to why the proposed deletion of the "material advantage" clause was rejected.

> "shall apply to all official support for exports of goods and/or services . . . which have repayment terms of . . . two years or more . . . . regardless of whether the official support is given by means of direct credit/financing, refinancing, *interest rate support*, guarantee or insurance" (emphasis added).

Accordingly, 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.[206] Thus, Brazil's view that developing country Members cannot afford to use the safe haven of the second paragraph of item (k) and must therefore rely on the "material advantage" clause of the first paragraph of item (k), as interpreted by Brazil, is also incorrect.

7.32. Finally, not only is item (k) on its face *not* a provision relating to special and differential treatment – which provisions may be found in Article 27 of the SCM Agreement – but Brazil's interpretation of material advantage could actually undermine the value of Article 27 for developing country Members. In particular, if the Panel were to accept the interpretation of material advantage advanced by Brazil, the first paragraph of item (k) could – as noted in paragraph 7.26 above -- be used by developed country Members as a justification to match, with export subsidies that would otherwise be prohibited, export subsidies provided by developing countries consistent with Article 27. Thus, while Brazil's interpretation of "material advantage" may serve the interests of one particular developing country Member with respect to its defense of one particular type of subsidy in one particular dispute, it cannot be generalized from this that Brazil's interpretation of the "material advantage" clause is necessary to protect the interests of developing country Members collectively. Rather, Brazil's interpretation would serve to benefit developing country Members only to the extent that one considers that a general lowering of the level of SCM Agreement disciplines on export subsidies applicable to all WTO Members is in the interests of developing country Members.

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

7.34. Applying the above standard to the case at hand, we consider it evident that PROEX payments result in the availability of export credit for Brazilian regional aircraft on terms which are more favourable than the terms that would otherwise be available with respect to the transaction in question. This follows from the very design of PROEX and the manner in which PROEX interest rate equalization operates. As characterized by Brazil, the purpose of PROEX payments is to improve the terms of export credit financing that would otherwise be available to purchasers of Brazilian regional aircraft and other

[206] Because Brazil has not invoked the second paragraph of item (k) as a defense in this dispute, we need not consider the application of that provision to PROEX payments. However, we note that the *Finan Report's* contention that PROEX interest rate equalization would not "by definition" be permitted by the OECD Arrangement because it is "designed to offset a portion of Brazil risk" is mistaken. In support of its contention, the *Finan Report* relies on paragraph 20 of the OECD Arrangement, which provides that:

> "[t]he Participants providing official support through direct credits/financing, refinancing, export credit insurance and guarantees, shall charge no less than the minimum premium benchmarks for the sovereign risk and the country credit risk, irrespective of whether the buyer/borrower is a private or a public entity."

Paragraph 20, however, excludes "interest rate support" from the categories of official support for which a minimum premium must be charged, presumably because in the case of interest rate support the government does not bear the risk of loss in the case of default. In any event, these premia relate to the risk relating to the country of the *buyer/borrower*, not that of the *lender*.

Brazilian products by offsetting "Brazil risk". Thus, under the PROEX interest rate equalization scheme EMBRAER and its export customers are free to negotiate the best export credit terms they may obtain in the market, irrespective of whether the lender is a Brazilian or foreign financial institution. As a tool to obtain the most favourable terms possible, they may request a letter of commitment from the Government of Brazil committing Brazil to provide fixed PROEX interest rate equalization payments of 3.8 percentage points to the lender; there is no requirement to demonstrate in a particular case that a 3.8 percentage point level is necessary to compensate for the lender's higher cost of funds. The payments may be used to improve the export credit terms in one of several ways. For example, the availability of the payments may be used to negotiate lower interest rates for the export credits in question than would otherwise be available for the transaction. In the alternative, the lending bank may agree to discount the bonds and to pass the sum along to the purchaser/borrower as a cash discount. In any event, we consider that, as a matter of logic, the payments will as a natural consequence allow EMBRAER and the purchaser to negotiate more favourable export credit terms than they could otherwise achieve in the marketplace.

7.35. We recall Brazil's acknowledgement that its "material advantage" argument constitutes an affirmative defense and, therefore, the burden of establishing entitlement to it is on Brazil. In this case, not only has Brazil failed to demonstrate that PROEX payments do not allow the purchaser of Brazilian regional aircraft to obtain more favourable export credit terms than the terms that would otherwise be available to the purchaser with respect to the transaction in the market, but Brazil has conceded to the contrary. Thus, in response to a question from the Panel[207], Brazil stated that:

> "PROEX presumably would always be more favorable to the purchaser than the terms it could obtain on its own; otherwise, the purchaser would have no interest in PROEX. If the PROEX-supported export credit term is compared merely to the credit terms a particular buyer could obtain on its own, PROEX could never provide assistance and always would be at a disadvantage vis-à-vis competitors supported by an export credit agency, whether that agency's programmes were or were not consistent with WTO obligations."

Brazil makes a similar admission in the Finan Report, where it states that:

> "Brazil's PROEX programme, applied to support exports of regional aircraft, acts to reduce the cost of export financing for the aircraft buyer."[208]

Thus, we consider that as a factual matter Brazil does not argue that PROEX payments do not confer a "material advantage" as that term has been interpreted by this Panel.

7.36. Neither has Brazil asserted, much less submitted evidence supporting an assertion, that any specific transactions relating to the export of Brazilian regional aircraft supported by PROEX payments have not resulted in export credit terms that are more favourable than the terms that would otherwise have

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[207] The question asked by the Panel was as follows: "Canada argues that the phrase 'in the field of export credit terms' as used in item (k) of Annex I of the SCM Agreement is limited to the interest rates and other transaction costs. Assuming for the sake of argument that this view is correct, what would be the appropriate benchmark for a comparison? Specifically, should the export credit terms of the transaction supported by PROEX interest rate equalization be compared to the export credit terms that would be available to the purchaser of EMBRAER aircraft on the market for the purchase of those aircraft if the PROEX interest rate equalization were not available for the transaction, or should it relate to the export credit terms available (including through official financing at OECD consensus rates by a Participant to the OECD Arrangement) to the purchaser if it purchased a competing civil aircraft?" Brazil responded that, "[w]ith regard to the two specific examples, Brazil would answer 'The latter'". The quote above followed.

[208] *Finan Report*, p. 1.2.

been available to the purchaser in the market with respect to those transactions. In fact, Brazil has not submitted any significant evidence regarding the specific terms and conditions, such as the interest rate, at which export credits supported by PROEX payments were provided, much less information regarding the export credit terms that would otherwise have been available with respect to the transaction in the market. Brazil did assert that, "in transactions when the lender was inside Brazil, the actual interest rate was always above LIBOR or the OECD rate in practice." But even with respect to this assertion, which in any event is not relevant in our view to the proper application of the "material advantage" clause, Brazil has not provided any supporting evidence. To the contrary, in response to a question from the Panel asking for specific information with respect to each transaction alleged by Brazil to be at or above the CIRR rate[209], Brazil responded that:

> "[t]his information requested by the Panel is not readily available to PROEX administrators. These authorities simply ensure that the bonds are issued to the agent bank and have no control, jurisdiction or access to specific details of the commercial transactions . . . ."[210]

In fact, with the respect to the one transaction supported by PROEX payments with respect to which Brazil has provided detailed information -- on a Business Confidential basis – it is clear that the PROEX payments resulted in a very substantial improvement in the export credit terms as compared to the terms that could have been obtained in the absence of the payments.

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

E. IS THE PROHIBITION ON EXPORT SUBSIDIES INAPPLICABLE TO BRAZIL BY REASON OF ITS STATUS AS A DEVELOPING COUNTRY MEMBER?

7.38. In the foregoing sections of this Report, we have found that PROEX payments are subsidies within the meaning of Article 1 of the SCM Agreement, and that those subsidies are contingent upon exportation within the meaning of Article 3.1(a) of that Agreement. Further, we have found that Brazil has not demonstrated that those subsidies are "permitted" by the first paragraph of item (k) of the SCM Agreement. In the usual case, this would be sufficient to establish that the subsidies in question are

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[209] The CIRR rate is the "commercial interest reference rate" which represents the minimum interest rate to be charged on officially supported export credits under the OECD Arrangement.

[210] The question posed by the Panel was: For each sale of EMBRAER regional aircraft supported by PROEX interest rate equalization which you contend was at an interest rate at or above the CIRR rate (taking into account the interest rate equalization), please specify: (a) the purchaser; (b) the financial institution providing the financing; (c) the date of the transaction; the currency in which export financing was provided; (e) the maturity of the financing; (f) the terms of the financing, including whether the interest rate is fixed or variable and, in the latter case, how it is established; (g) the rate of interest before and after PROEX interest rate equalization is considered. Please provide any supporting documentation which you consider necessary to support your factual assertions in this regard."

prohibited by Article 3 of the SCM Agreement. In this case, however, the parties agree that Brazil is a developing country Member within the meaning of the SCM Agreement. As such, Brazil is entitled to the extensive special and differential treatment accorded to such Members by Article 27 of the SCM Agreement. Accordingly, and as required by Article 12.11 of the DSU, we must now consider whether, under the facts of this case, Brazil is shielded from the Article 3.1(a) prohibition by reason of Article 27.

1. Is Article 27 Lex Specialis to Article 3?

7.39. Brazil argues *en passant* that Article 27 is *lex specialis* to Article 3, in that it provides special rules with regard to export subsidy programmes of developing country Members. In other words, it is Brazil's view that the specific provisions of Article 27 relating to developing country Members' export subsidies displace the general provisions of Article 3.1(a), and that it is therefore not possible for developing country Members to act in a manner inconsistent with Article 3. Because Canada has not alleged that Brazil has violated Article 27 of the SCM Agreement, nor is any such claim within the Panel's terms of reference, Brazil considers that the Panel must deny Canada's complaint in this dispute.

7.40. Brazil has not vigorously pursued its *lex specialis* argument, and for good reason. In our view, Brazil's argument cannot be reconciled with the ordinary meaning of Article 27.2 of the SCM Agreement. It will be recalled that Article 27.2 provides that "[t]he prohibition of paragraph 1(a) of Article 3 shall not apply to . . . developing country Members [other than those referred to in Annex VII] for a period of eight years from the date of entry into force of the WTO Agreement*, subject to compliance with the provisions of paragraph 4* [of Article 27]" (emphasis added). It is evident to us from this language that Article 27 does not "displace" Article 3.1(a) of the SCM Agreement unconditionally as argued by Brazil. Rather, the prohibition of Article 3.1(a) shall not apply "subject to compliance with the provisions of paragraph 4". The exemption for developing country Members other than those referred to in Annex VII from the application of the Article 3.1(a) prohibition on export subsidies is clearly conditional on compliance with the provisions in paragraph 4 of Article 27. Thus, we consider that, where the provisions in Article 27.4 have not been complied with, the Article 3.1(a) prohibition applies to such developing country Members.

7.41. Although we have addressed Brazil's *lex specialis* argument for the sake of completeness, Brazil arguably abandoned its *lex specialis* argument during the course of the proceedings. Thus, in a question to Brazil the Panel quoted Article 27.2(b) and stated that "[i]t could be argued that, by negative implication, the prohibition <u>does</u> apply. Please comment." Brazil responded that "[t]his is true, but the central question is which party bears the burden of proof . . . ." Accordingly, it is to that question that we now turn.

2. Article 27.4 conditions and burden of proof

7.42. As explained above, we consider that the prohibition on export subsidies applies to developing country Members other than those referred to in Annex VII[211] in the event of non-compliance with the provisions in Article 27.4. In Canada's view, Article 27.4 contains three relevant conditions. *First*, export subsidies must be phased out within the eight-year period. *Second*, the level of export subsidies must not increase during that period. *Third,* export subsidies must be eliminated within a period shorter than eight years when the use of these subsidies is not consistent with the Member's development needs.

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[211] For the sake of convenience, we will generally refer to "developing country Members other than those referred to in Annex VII" simply as "developing country Members." This should not be construed as suggesting that the non-application of Article 3.1(a) to developing country Members referred to in Annex VII is conditioned on compliance with the provisions of Article 27.4.

Before turning to a discussion of the specific elements of Article 27.4, however, we must consider the issue, which has been argued extensively by the parties, regarding who bears the burden of proof with respect to compliance with the provisions of Article 27.4.

7.43. Article 27.2(b) of the SCM Agreement provides:

> 27.2 The prohibition of paragraph 1(a) of Article 3 shall not apply to:
>
> …………….
>
> (b) developing country Members for a period of eight years from the date of entry into force of the WTO Agreement, subject to compliance with the provisions of paragraph 4.

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

> 27.4 Any developing country Member referred to in paragraph 2(b) shall phase out its export subsidies within the eight-year period, preferably in a progressive manner. However, a developing country Member shall not increase the level of its export subsidies[55] and shall eliminate them within a period shorter than that provided for in this paragraph when the use of such export subsidies is inconsistent with its development needs….
>
> [55]For a developing country Member not granting export subsidies as of the date of entry into force of the WTO Agreement, this paragraph shall apply on the basis of the level of export subsidies granted in 1986.

7.44. The parties are in fundamental disagreement about the legal nature of the relationship between Article 3.1(a) and the above-cited provisions of Article 27. In particular, they disagree as to whether the provisions in Article 27.4 are an integral part of Canada's claim of violation of Article 3.1(a) with respect to which Canada bears the burden of proof, or whether these provisions constitute an "exception" from, or "affirmative defense" to, the prohibition laid out in Article 3.1(a) with respect to which Brazil bears the burden of proof. Canada contends that, because Article 27 reflects special and differential treatment for developing country Members, it is an exception to the general obligations of the SCM Agreement. In Canada's view, Article 27.2(b) sets forth a "limited and conditional exception" to the prohibition in Article 3.1(a). Canada relies on the Panel Report in *Argentina – Footwear I*[212] for the proposition that "it is for the party invoking an exception or an affirmative defense to prove that the conditions contained therein are met". According to Canada, in order to benefit from the "exception" in Article 27.2(b), Brazil bears the burden of demonstrating that it has complied with the conditions of Article 27.4.

7.45. Brazil disputes that Article 27.2(b) can be characterized as an "exception" to the prohibition set out in Article 3.1(a), or that it bears the burden of proof with respect to compliance with that provision and with the conditions stipulated in Article 27.4. For Brazil, Article 27 consists of carefully negotiated language that reflects a carefully drawn balance of rights and obligations. Brazil points out that the text of the provision states "clearly and unequivocally" that "the prohibition of paragraph 1(a) of Article 3 shall not apply" to developing countries, subject to the conditions in Article 27.4. In Brazil's view,

[212] *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/R, para. 6.35, adopted 22 April 1998.

Canada, as the complaining party, bears the burden of establishing that Brazil has not complied with these conditions. The third parties, the European Community and the United States, support Canada's position.

7.46. There appears to be no overriding general principle to guide a panel in distinguishing between an element of a claim of violation of a provision of the WTO Agreement and an "exception" from, or "affirmative defence" to, a provision of the WTO Agreement. However, it is clear that the mere characterization of a provision as an "exception" will not necessarily determine which party bears the burden of proof with respect to establishing the elements contained in that provision. Thus, we note that, in *EC Measures Concerning Meat and Meat Products (Hormones)*, for example, the Appellate Body stated that:

> "The general rule in a dispute settlement proceeding requiring a complaining party to establish a *prima facie* case of inconsistency … is *not* avoided by simply describing that provision as an 'exception.'"[213]

7.47. Nevertheless, it is well-established in WTO practice that a party who asserts the affirmative of a particular claim or defence bears the burden of proof with respect to that claim or defense. As the Appellate Body stated in *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*:

> "… it is a generally-accepted canon of evidence in civil law, common law, and in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption."[214]

7.48. Therefore, in determining which party bears the burden of proof in this case with respect to the compliance with the provisions of Article 27.4 of the SCM Agreement, it is necessary to consider whether that provision is in the nature of an element of a claim of violation of Article 3.1(a) where the Member complained against is a developing country Member within the meaning of Article 27.2(b), or whether it is in the nature of an affirmative defence that may be invoked by such a developing country Member in response to a claim of inconsistency with Article 3.1(a). If it is an element of a claim of inconsistency with Article 3.1(a), then, in this case, it would fall to Canada, as the complaining party, to adduce evidence sufficient to raise a presumption that Brazil was *not in compliance* with the conditions set out in Article 27.4, at which point the burden would shift to Brazil to rebut this presumption. If, on the other hand, Article 27.4 is in the nature of an affirmative defence, it would be for Brazil to adduce evidence sufficient to raise a presumption that it was *in compliance* with the provisions in Article 27.4, at which point the burden would shift to Canada to rebut this presumption.

7.49. In our view, a determination of the nature of this provision, and an examination of which party bears the burden of proof under it, must turn on the actual wording of the relevant text of the Agreement in its context, and in light of the object and purpose of the SCM Agreement. We note that Article 27.2(b)

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[213] WT/DS26/AB/R, WT/DS48/AB/R, para. 104, adopted 13 February 1998.

[214] WT/DS33/AB/R, p. 14, adopted 23 May 1997.

contains an explicit textual link between itself and Article 27.4, as well as between Article 3.1(a) and Article 27.4. It states:

> "The prohibition of paragraph 1(a) of Article 3 shall not apply to: … other developing country Members for a period of eight years from the date of entry into force of the WTO Agreement, *subject to compliance with the provisions in paragraph 4*." (emphasis added)

Because of this explicit textual linkage between Article 27.2(b) and Article 27.4, we consider that these paragraphs must be read in conjunction in order to determine the legal nature of the conditions contained in Article 27.4. Due to the wording of Article 27.2(b) highlighted above, we believe this provision to be determinative for the issue of allocating the burden of proof with respect to the conditions contained in Article 27.4.

7.50. An essential element in establishing a claim of inconsistency with a provision of the WTO Agreement is to demonstrate that the particular provision *applies* to the particular Member in question and to the particular factual situation in a given dispute. Part and parcel of asserting the affirmative of a particular claim is to demonstrate that the legal provision forming the basis for that claim applies to the Member against whom that legal provision is being invoked. Naturally, there will be no inconsistency with a given provision if a Member is explicitly excluded from its scope of application or a situation is explicitly identified in the text of the Agreement as falling outside the scope of application of a particular provision. In this regard, we recall that Article 27.2(b) states that: "The prohibition of paragraph 1(a) of Article 3 *shall not apply to*: … other developing country Members for a period of eight years from the date of entry into force of the WTO Agreement, subject to compliance with the provisions in paragraph 4." (emphasis added) Clearly, on the basis of the plain meaning of the text of the provision, developing country Members falling within Article 27.2(b) -- that is, developing country Members (other than those referred to in Annex VII) that are in compliance with the provisions of Article 27.4 – do not fall within the scope of application of the prohibition contained in Article 3.1(a) until 1 January 2003.

7.51. We consider that this interpretation is supported by the context of Article 27.2(b). Article 27 is entitled "Special and Differential Treatment of Developing Country Members" and this provision constitutes Part VIII of the SCM Agreement, entitled "Developing Country Members". Thus, the context of the provisions indicates that they extend "special and differential treatment" to developing country Members.

7.52. The context of Article 27.2(b) also includes Article 27.3 and Article 27.7 of the SCM Agreement. Article 27.7 reads:

> 27.7 The provisions of Article 4 shall not apply to a developing country Member in the case of export subsidies which are in conformity with the provisions of paragraphs 2 through 5. The relevant provisions in such a case shall be those of Article 7.

We consider that, analogous to Article 27.2(b) in relation to Article 3.1(a), this provision would exclude developing country Members from the scope of application of Article 4 in certain circumstances. The phrase "subject to compliance with the provisions in paragraph 4" contained in Article 27.2(b) can, in our view, be seen as analogous to the phrase "which are in conformity with paragraphs 2 through 5" contained in Article 27.7. This supports an interpretation of Article 27.2(b) that developing country Members are excluded from the scope of application of the substantive obligation in question provided that they comply with certain specified conditions.

7.53. Moreover, Article 27.3 states:

> 27.3 The prohibition of paragraph 1(b) of Article 3 shall not apply to developing country Members for a period of five years, and shall not apply to least-developed country Members for a period of eight years, from the date of entry into force of the WTO Agreement.

This provision reflects that developing country Members are excluded outright from the scope of application of the substantive obligation of Article 3.1(b) (the prohibition on subsidies contingent on the use of domestic over imported goods) for a stipulated period of time. As contextual for Article 27.2(b), it supports the view that the relevant provisions of Article 27, which extend "special and differential treatment to developing countries", serve to exclude, in a qualified or unqualified manner, certain developing countries from the scope of application of certain substantive obligations found elsewhere in the Agreement for specified periods of time. Moreover, in Article 27.1, Members "recognize that subsidies may play an important role in economic development programmes of developing country Members". Therefore, on the basis of the text and context of Article 27.2(b), we consider that Article 27.2(b) serves to exclude the developing country Members referred to in that provision from the scope of application of the prohibition in Article 3.1(a), subject to compliance by the developing country Member in question with the provisions in Article 27.4.

7.54. This view, derived from the text and context of Article 27.2(b), reflects a legal relationship between Article 3.1(a), Article 27.2(b) and 27.4 of the SCM Agreement that is qualitatively different from the relationship between, for instance, the substantive obligations contained in Articles I or III of the GATT 1994 and the affirmative defences set out in the "general exceptions" of Article XX of the GATT 1994. Article 27.2(b) excludes from the scope of application of Article 3.1(a) a developing country Member referred to in Article 27.2(b) for a period of eight years from the date of entry into force of the WTO Agreement. In other words, Article 27.2(b) recognizes the autonomous right of certain developing country Members to grant or maintain export subsidies during a stipulated period. According to the specific language of that provision, this right is "subject to compliance with the provisions of paragraph 4" of Article 27. Paragraph 4 of Article 27 then sets out the conditions with which a qualifying developing country Member must comply in order to be excluded from the scope of application of the prohibition in Article 3.1(a), that is, in order that the substantive obligation in Article 3.1(a) not apply to it. This contrasts markedly with a situation that could arise with respect to the affirmative defences set out in Article XI:2 or XX of the GATT 1994, where there is no dispute that the substantive obligation contained in, say, Article I or III of the GATT 1994, applies to the Member in question, but that Member argues that, while it may have acted inconsistently with a particular provision, it should be excused from the substantive obligation contained in that provision.[215]

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[215] We note that the Appellate Body stated the following in *EC – Hormones* (para. 104), in relation to the relationship between Article 3.1 and Article 3.3 of the *SPS Agreement*:

> "[t]he Panel posits the existence of a "general rule – exception" relationship between Article 3.1 (the general obligation) and Article 3.3 (an exception) and applies to the *SPS Agreement* what it calls "established practice under GATT 1947 and GATT 1994" to the effect that the burden of justifying a measure under Article XX of the GATT 1994 rests on the defending party. It appears to us that the Panel has misconceived the relationship between Articles 3.1, 3.2 and 3.3, a relationship discussed below, which is qualitatively different from the relationship between, for instance, Articles I or III and Article XX of the GATT 1994. Article 3.1 of the *SPS Agreement* simply excludes from its scope of

7.55. We draw, from WTO practice, further support for our view that the nature of the legal relationship between Articles 3.1, 27.2(b) and 27.4 of the SCM Agreement differs qualitatively from that between, say, Article III and Article XX of the GATT 1994. We note that, in addressing the nature of Article 6 of the Agreement on Textiles and Clothing in *United States – Shirts and Blouses*, the Appellate Body stated that Articles XI and XX are "limited exceptions from obligations under certain other provisions of GATT 1994, *not positive rules establishing obligations in themselves*". (emphasis added) Although Article 27.2(b) does not, in itself, establish any obligations, Article 27.4 does impose certain obligations, i.e., the obligation on developing country Members within the meaning of Article 27.2(b) to "phase out its export subsidies within the eight-year period, preferably in a progressive manner"; to "not increase the level of its export subsidies" and "to eliminate them within a period shorter than [eight years]when the use of such export subsidies is inconsistent with its development needs". This is not to say that Article 27.4 would necessarily form the legal basis for a separate claim of violation of the SCM Agreement.[216] Rather, because of the explicit textual link found in Article 27.2(b) between Articles 3.1(a), 27.2(b) and 27.4, the requirements of Article 27.4 must be considered in conjunction with Article 3.1(a) of the SCM Agreement in order to establish a claim of violation of that provision against a Member that is a developing country Member within the meaning of Article 27.2(b).

7.56. The fundamental issue before us, therefore, is whether the prohibition in Article 3.1(a) of the SCM Agreement *applies* to the developing country Member in question, rather than whether the developing country Member, having been found to be subject to the substantive obligations of Article 3.1(a), and having been found to have acted inconsistently with these obligations, can find justifying protection by invoking Article 27.2(b) in conjunction with Article 27.4. In our view, until non-compliance with the conditions set out in Article 27.4 is demonstrated, there is also, on the part of a developing country Member within the meaning of Article 27.2(b), no inconsistency with Article 3.1(a). We recall the words of the Appellate Body in *United States – Shirts and Blouses* that "a party claiming a violation of a provision of the WTO Agreement by another Member must assert and prove its claim."[217] Applying this terminology to the case at hand, we consider that, in order to assert and prove a claim of violation of Article 3.1(a) with respect to a Member that is a developing country Member within the meaning of Article 27.2(b), the Member asserting the claim must demonstrate that the substantive obligations contained in Article 3.1(a) of the SCM Agreement apply to the Member in question. In order to do this, the Member asserting the claim must demonstrate that the developing country Member concerned has not complied with the conditions stipulated in Article 27.4.

7.57. Where, as here, it is agreed that the Member in question is a developing country Member within the meaning of Article 27.2(b), it is for the Member alleging a violation of Article 3.1(a) of the SCM Agreement to demonstrate that the substantive obligation in that provision -- the prohibition on export subsidies -- applies to the developing country Member complained against. That is, it is for the complaining Member to demonstrate that the developing country Member in question is not in compliance with at least one of the elements laid out in Article 27.4. In light of the above, we consider that, in order to determine whether Brazil has acted inconsistently with Article 3.1(a), it is for Canada to establish that Article 3.1(a), in fact, applies to Brazil at the present time. Accordingly, we find that Canada bears the burden of proving that Brazil is not in compliance with the provisions of Article 27.4.

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application the kinds of situations covered by Article 3.3 of that Agreement . . . ." (footnotes omitted).

[216] Given that Canada has made no claim of a violation of Article 27.4, this is an issue we need not and do not decide in this dispute.

[217] WT/DS33/AB/R, p. 16, adopted 23 May 1997.

3. Has Brazil increased the level of its export subsidies?

7.58. Having resolved the question of burden of proof, we now turn to the first element of Article 27.4 identified by Canada, whether Brazil has increased the level of its export subsidies. It will be recalled that Article 27.4 provides, in relevant part, that "a developing country Member shall not increase the level of its export subsidies[55] . . . .". Canada asserts that Brazil has increased the level of its export subsidies. Brazil asserts, on the basis of the same data, that it has not increased the level of its export subsidies. Accordingly, before turning to the undisputed factual information submitted by the parties, we must consider a number of legal issues relating to the proper interpretation of this provision.

7.59. The first issue presented is whether "the level of export subsidies" referred to in Article 27.4 means the overall level of export subsidies of a Member during a given period, the level of export subsidies with respect to some given product during that period, or some other measurement. With respect to this issue, the parties generally agree that the "level of export subsidies" relevant to the analysis in this dispute is the overall level of Brazil's export subsidies. Although we do not decide that the overall level is the *only* possible basis for an examination of this issue, we do not see any reason to conclude that an analysis of the overall level of export subsidies is not *an* appropriate measure for the purposes of Article 27.4. The parties further agree that two programmes, PROEX and BEFIEX, are the only Brazilian export subsidy programmes relevant to this analysis. There is no information in the record before us suggesting the existence of export subsidies within the meaning of Article 3.1(a) of the SCM Agreement other than those provided pursuant to PROEX and BEFIEX. Accordingly, we will in this dispute examine the overall level of export subsidies provided by Brazil, i.e., the overall level of export subsidies provided under PROEX and BEFIEX.

7.60. The parties differ in one respect with respect to this issue. Canada contends that, because agricultural export subsidies are subject to special rules and separate reduction commitments under the Agreement on Agriculture, and because Article 13(c) of that Agreement exempts agricultural export subsidies that fully conform to Part V of that Agreement from the SCM Agreement's prohibition on export subsidies, such subsidies should be excluded in calculating the level of export subsidies under Article 27.4. Brazil disagrees, noting that Article 27 itself makes no distinction between agricultural and industrial subsidies. Brazil states, however, that neither PROEX nor BEFIEX are agricultural export subsidies, nor are they granted for the benefit of agricultural products. Canada has not contested Brazil's statements in this regard. Under these circumstances, we need not and do not decide whether the level of a Member's export subsidies within the meaning of Article 27.4 includes agricultural export subsidies.

7.61. The parties disagree as to the benchmark period against which an examination as to whether a Member has increased the level of its export subsidies should be made. Brazil asserts that, in the circumstances of this dispute, the appropriate benchmark is 1991, as that is the year in which the PROEX programme was first enacted. Canada considers that the relevant benchmark is 1994, as the condition in Article 27.4 not to increase the level of one's export subsidies became effective on 1 January 1995. We agree with Canada. The WTO Agreement entered into force on 1 January 1995. Article 27.2(b) allows developing country Members to maintain export subsidies for eight years from the date of entry into force of the WTO Agreement, provided they comply with the requirement of Article 27.4 that they not increase the level of their export subsidies during that period. Thus, logic would suggest that the appropriate reference period is the level of export subsidies in the period immediately preceding the date of entry into force.

7.62. The foregoing interpretation is confirmed by footnote 55. Footnote 55 provides that, "[f]or a developing country Member not granting export subsidies *as of the date of entry into force of the WTO Agreement,* this paragraph shall apply on the basis of the level of export subsidies granted in 1986."

Footnote 55 would appear to recognize that it would be inappropriate to impose on developing country Members which had before the entry into force of the WTO Agreement autonomously eliminated their export subsidies without a multilateral obligation to do so an obligation not to increase the level of its export subsidies above a zero level. Rather, it offers for such Members a ceiling level of export subsidies based on their 1986 level. Implicit in this explanation is that, absent footnote 55, a developing country Member which granted no export subsidies *as of the date of entry into force of the WTO Agreement* would be prohibited from providing any export subsidies during the eight-year transition period. Thus, footnote 55 indicates that the relevant benchmark period against which the obligation not to increase the level of export subsidies should be measured is a period immediately preceding the date of entry into force of the WTO Agreement.

7.63. Nor has Brazil offered any cogent reason why the Panel should use the year 1991 as a benchmark. We note that the sole stated basis for Brazil's view that we should look to 1991 rather than 1994 as the benchmark period is that 1991 is the year in which the PROEX programme was created. Given the agreement of the parties that the level of export subsidies in this dispute should relate to the overall level of Brazil's export subsidies, and not to the level of PROEX export subsidies alone, we fail to understand why the date on which PROEX was created should be relevant to our choice of a benchmark period. In the circumstances of this dispute, it would be equally logical – or illogical -- to use the date on which BEFIEX was enacted as the benchmark period.

7.64. Brazil contends that, if the Panel chooses not to use 1991 as a benchmark period, it should at least use a weighted average of the three or four years prior to the date of entry into force as the relevant period. It argues that such a benchmark would help reduce the distortion of the impact of a single year on the volatile economies of developing country Members. Once again, however, we consider that footnote 55 gives us useful guidance by providing at least a presumptive period for use as a benchmark. Footnote 55 provides for the use of "the level of export subsidies granted in 1986" when the developing country Member was not granting export subsidies as of the date of entry into force of the WTO Agreement. In other words, footnote 55 envisions using a one-year period as a benchmark for determining a developing country Member's level of export subsidies. Under these circumstances, and in the absence of any compelling reason to deviate from the approach suggested by footnote 55, we consider that it would be most appropriate in this case to use the single calendar year 1994 for the purpose of this analysis.

7.65. The parties also disagree vigorously with respect to whether, when considering the level of export subsidies, the Panel should examine budgeted amounts or actual expenditures. Canada contends that the level of export subsidies should be assessed by reference to actual expenditures, while Brazil contends that budgeted amounts represent the appropriate basis for the calculation. We agree with Canada. In our view, the level of a Member's export subsidies in its ordinary meaning refers to the level of subsidies actually provided, not the level of subsidies which a Member planned or authorized its government to provide through its budgetary process. This reading is in our view confirmed by footnote 55, which provides that, "[f]or a developing country Member not *granting* export subsidies as of the date of entry into force of the WTO Agreement, this paragraph shall apply on the basis of the level of export subsidies *granted* in 1986."(emphasis added). The verb "grant" has been defined to mean, *inter alia*, "to bestow by a formal act"[218] and "give, bestow, confer".[219] Thus, the verb "grant" in its ordinary meaning implies the actual provision of a subsidy, not its mere budgeting.[220] Accordingly, the SCM Agreement envisions that

[218] *Shorter Oxford English Dictionary* (third edition).

[219] *Webster's Third New International Dictionary.*

[220] Brazil defines "grant", without citation, as meaning "to agree, consent" or "to promise, undertake (which means 'to give formal promise or pledge')". Brazil further argues that the Portuguese term "dotação orçamentária" signifies a formal, legal binding promise – not an estimate – to the Brazilian exporter or financial institution to provide funds earmarked for PROEX in the budget, on a first-come, first-served basis, until the appropriated resources are depleted. While the verb "grant" may have a

the proper point of reference in determining whether a Member has increased the level of its export subsidies is expenditures rather than budgeted amounts.

7.66. Brazil argues that "budgeted amounts, rather than expenditures, are the proper basis of comparison because they are the responsibility of the Member governments of the WTO." It contends that under the expenditure approach, a Member could increase its budgetary amounts and meet the requirements of Article 27.4 if the private sector did not fully utilise the budgeted sum, or fall out of compliance if the private sector utilised a sufficiently larger share of a smaller budgeted amount. We do not find these arguments compelling. A Member should be aware of the level of its past expenditures for export subsidies. If that Member budgets a larger amount than the amount it expended on export subsidies in a prior period, it should not be surprised if the private sector utilises that budgeted amount and as a result the Member is deemed to have increased the level of its export subsidies. On the other hand, if a Member increases the amount budgeted for export subsidies it may be that the Member intended to increase the level of its export subsidies, but that does not mean that it has actually increased the level of its export subsidies. In this respect, we agree with Canada that an expenditure-based measurement is consistent with the object and purpose of the SCM Agreement, which is to reduce economic distortions caused by subsidies. It seems to us that an increase in the level of export subsidies budgeted, which increase is not in fact actually realized, represents no more than a failed attempt by the subsidizing Member to increase the level of its export subsidies. That failed attempt in itself does not affect the interests of other Members.

7.67. As noted in paragraph 7.13 above, the parties disagree about the form of the financial contribution involved in this dispute, an issue which they consider has implications with respect to the question of when PROEX payments should be considered to have been "granted" for the purposes of calculating the level of Brazil's export subsidies in terms of expenditures. In Canada's view, PROEX payments involve a direct transfer of funds within the meaning of Article 1.1(a)(1) which occurs either when payments are made pursuant to a NTN-1 bond (i.e., where the lender redeems the bonds) or, in the alternative, when NTN-1 bonds are issued to an agent bank. Brazil, argues, to the contrary, that PROEX interest rate equalization in the first instance involve a potential direct transfer of funds which occurs at the moment that a letter is issued by the Export Credit Committee committing PROEX to provide interest rate equalization support for a transaction, provided that it is entered into according to the terms and conditions specified in a request for approval.

7.68. We recall that Article 1.1(a)(1) of the SCM Agreement provides that there is a financial contribution where, *inter alia*:

> "a government practice involves a direct transfer of funds (e.g., grants, loans and equity infusion), potential direct transfer of funds or liabilities (e.g., loan guarantees)."

We believe that a "potential direct transfer of funds" exists only where the action in question gives rise to a benefit and thus confers a subsidy irrespective of whether any payment occurs. In arriving at this view, we have taken contextual guidance from the example of loan guarantees provided in Article 1.1(a)(1) of the SCM Agreement. Whether or not a loan guarantee confers a subsidy does not depend upon whether a payment occurs (i.e., whether the beneficiary of the guarantee defaults and the government is required to make good on the guarantee). For example, Article 14 of the SCM Agreement provides that, when examining benefit to the recipient in a countervail context, "a loan guarantee by a government shall not be

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variety of meanings depending the context in which it is used, it is clear to us that, in the context of the phrase "export subsidies granted in 1986", the meanings cited by Brazil are inapposite, and it cannot reasonably be contended that a subsidy is "granted" merely because the government makes a budgetary authorization.

considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that a firm would pay on a comparable commercial loan absent the government guarantee." Thus, whether or not a loan guarantee confers a benefit depends on its effects on the terms of the loan and not on whether there is a default. Similarly, whether an export credit guarantee programme is an export subsidy under item (j) of the Illustrative List of Export Subsidies depends upon the premium rates charged and not upon whether a subsequent default occurs. While loan guarantees clearly are only one example of a "potential direct transfer of funds", we consider that other measures must share this basic characteristic in order to fall within that category of financial contribution.

7.69. In our view, if the category of potential direct transfers of funds referred simply to the situation where a government may in the future make a payment, almost any direct transfer of funds could, at an earlier date, be qualified as a potential direct transfer of funds. Nor do we see any reason to believe that a possible future payment is a "potential direct transfer of funds" merely because of a high probability that a payment will actually occur. The word "potential" has been defined as "possible as opposed to actual" or "capable of coming into being".[221] If the determination whether a measure was a "potential direct transfer of funds" depended upon the degree of likelihood or probability that a payment would subsequently occur, then the drafters surely would have chosen an adjective more suggestive of high probability than "potential."

7.70. Applying this approach to the case at hand, we recall Brazil's view that the issuance of a letter of commitment constitutes a potential direct transfer of funds. In this case, however, it clearly is not the alleged "potential direct transfer of funds", i.e., the letter of commitment, that confers the benefit. Rather, the benefit in the PROEX interest rate equalization scheme derives from the fact that a payment, i.e., a direct transfer of funds, has been or will be made. Brazil argues a potential direct transfer of funds exists here because Brazil is legally obligated under the letter of commitment to provide PROEX interest equalization payments *if* the export transaction to which the letter of commitment relates is concluded on the terms set forth in the request letter.[222] As explained above, the existence of a "potential direct transfer of funds" does not depend upon the probability that a payment will subsequently occur. Rather, the issue of whether and to what extent Brazil has taken a legal commitment to provide PROEX payments is relevant to determining *when* Brazil can be considered to have provided a *direct transfer of funds* in the form of a PROEX payment.

7.71. At what point in time can Brazil be considered to "grant" PROEX payments in the form of "direct transfers of funds"? As noted above, the verb "grant" has been defined to mean, *inter alia*, "to bestow by formal act" and "give, bestow, confer". Arguably, therefore PROEX payments may be "granted" where the unconditional legal right of the beneficiary to receive the payments has arisen, even if the payments themselves have not yet occurred. It is clear to us, however, that PROEX payments have not yet been "granted" at the time a letter of commitment is issued. We note that the issuance of a letter of commitment, even if legally binding on the Government of Brazil in the event certain conditions are fulfilled, provides no assurance that PROEX payments will actually be made. To the contrary, at the time the letter of commitment is issued no export sales contract has been signed, and the letter of commitment expires if a contract that conforms to the request for approval is not negotiated and signed within 90 days. Even the signing of a contract within that period does not trigger the issuance of bonds; in fact, business confidential information submitted by Brazil confirms that letters of commitment are issued with respect

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[221] *Shorter Oxford English Dictionary* (third edition).

[222] Brazil submitted a legal opinion prepared by a Brazilian lawyer for the proposition that the Government of Brazil cannot under Brazilian law annul or revoke a letter of commitment, once issued. *Legal Opinion from Professor Luiz Olavo Baptista*, Brazil exhibit 17.

to options as well as firm contracts, which options may never be exercised. Rather, the right to receive the PROEX payments only arises after the conditions relating to receipt of PROEX payments, and specifically the condition that the product in question actually be exported, has been fulfilled. Thus, NTN-1 bonds are only issued if and when the aircraft whose financing is being supported by the interest rate equalization is actually exported. Accordingly, at the time the letter of commitment is issued, no PROEX payments have been made, nor has the beneficiary earned the unconditional right to receive PROEX payments. Rather, the issuance of the letter of commitment means only that, if an export transaction is closed within a certain period of time, and if the product in question actually is exported, a right to receive PROEX payments will arise.

7.72. The question remains whether PROEX payments are "granted" when the bonds are issued or whether they are granted only when the bonds are redeemed on a semiannual basis. In our view, PROEX payments should be considered to be "granted" when bonds are issued and title to those bonds is transferred to the lender financial institution. In this respect, we note that the terms "funds" is defined as, *inter alia*, "pecuniary resources". The word "pecuniary", in turn, is defined as, *inter alia*, "of, belonging to, or having relation to money".[223] Thus, the term "funds" can be defined to mean "resources of, belonging to, or having relation to money". It is true that the bonds are not fully equivalent to money, in that they can only be redeemed at some future date. Nevertheless, we consider that the transfer of title of these bonds to the lender should be considered to be the moment that a direct transfer of funds occurs. In this respect, we note that, while the bonds cannot be immediately redeemed, they are freely negotiable.[224] The parties agree that lenders may exercise their right to sell these bonds – albeit at a discount as determined by the market -- to other entities rather than waiting until maturity to redeem the bonds themselves. Thus, at the point that title to the bonds is passed to the lenders, those lenders are the holders of a property right with a market value which is immediately realisable. Accordingly, we conclude that PROEX payments are "granted" at that point, and we will calculate the Brazil's PROEX expenditures on that basis.

7.73. Finally, we note that, while the parties appear to agree that "the level of export subsidies" should be measured in US dollars in this case, they disagree as to whether the level should be expressed in constant or nominal dollars. Brazil argues that it is logical to use a constant point of comparison to measure the level of a developing country Member's export subsidies. Canada responds that there is no indication in Article 27.4 that adjustment should be made for inflation, and that in cases – such as Annex IV:5 to the SCM Agreement -- where the drafters considered that an inflation adjustment was appropriate, they specifically provided for it. In our view, however, it is appropriate in this case to use constant dollars, as that will provide a more meaningful assessment as to whether Brazil has increased the level of its export subsidies. We note that, in this case, the conclusion with respect to this issue would be the same whether constant or nominal dollars are used.

7.74. In conclusion, we consider that the level of Brazil's export subsidies should be appropriately measured in this case by reference to Brazil's overall level of export subsidies, which the parties agree consist of PROEX and BEFIEX subsidies. We further consider that the proper measure of the level of Brazil's export subsidies is the level of its expenditures, not its budgeted amounts, and that the proper benchmark period against which to examine whether that level has increased is calendar year 1994. We see no reason not to measure the level in US dollars, consistent with the data submitted by both parties.

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[223] *Shorter Oxford English Dictionary* (third edition).
[224] Ministry Order Nos. 121/97 of 12 August 1997 and 18/98 of 27 January 1998.

7.75. There is no factual dispute among the parties regarding the evidence submitted to the Panel regarding the level of Brazil's export subsidies. The data which are relevant in light of our legal analysis are reflected in Table 9:

TABLE 9

**Brazilian Export Subsidies
(PROEX and BEFIEX)**

	Total Expenditures* (current US$)	Total Expenditures (1994 constant US$)
1994	339.6	340
1995	269.5	263
1996	286.7	275
1997	412.5	389
1998**	537.8	502

Source: *Brazil exhibit 20.*
* PROEX payments appear as expenditures in the year the bonds are issued.
** PROEX expenditures January-October.

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

7.76. For the foregoing reasons, we conclude that Brazil has "increased the level of its export subsidies" within the meaning of Article 27.4 of the SCM Agreement.

4. Has Brazil complied with the condition that it "phase out its export subsidies within the eight-year period"?

7.77. Canada contends that, under Article 27.4, a developing country Member seeking to benefit from the non-application of the Article 3.1(a) prohibition must phase out its export subsidies within eight years from the date of entry into force of the WTO Agreement. In Canada's view, this provision reflects two requirements. First, a developing country is required to "bring gradually out of use", its export subsidies during the eight-year period. Second, the developing country Member is required to terminate its export subsidies by the end of the eight-year period. In Canada's view, Brazil has failed to comply with either condition.[225]

7.78. We note, first, that there can be no question, and Brazil does not contest, that a developing country Member other than one referred to in Annex VII is as a general rule required by Articles 27.2(b) and 27.4 to eliminate its export subsidies within eight years from the date of entry into force of the WTO Agreement. We further note, however, that Article 27.4 envisions that an extension of that period may be granted on request of the developing country Member if the Committee on Subsidies and Countervailing Measures determines that an extension of the period is justified, after examining all the relevant

[225] It could also be argued that the "phase out" obligation entails a requirement not to increase the level of a Member's export subsidies. In light of our findings with respect to the explicit requirement of Article 27.4 that a Member not increase the level of its export subsidies, we need not consider this matter further.

economic, financial, and development needs of the developing country Member. We further consider it evident that any such extension granted by the Committee would effectively extend the eight-year period specified in Article 27.2(b) and would render the prohibition on export subsidies under Article 3.1(a) inapplicable for the period for which the extension was granted (assuming the developing country Member continued to comply with the other conditions found in Article 27.4).

7.79. With respect to a developing country Member's obligations during the eight-year period, Article 27.4 provides that "[a]ny developing country Member referred to in paragraph 2(b) shall phase out its export subsidies, preferably in a progressive manner." We agree with Canada that the "principal interpretive challenge" presented by this provision is the need to reconcile the *mandatory* language providing that a developing country Member "shall phase out its export subsidies" with the hortatory language in the final clause encouraging Members to perform their phase-out in a progressive manner. In its ordinary meaning, the term "phase out" means, *inter alia*, "to discontinue the practice, production or use of by phases."[226] Thus, Article 27.4 appears to require the phased elimination of export subsidies within the eight-year period. On the other hand, Article 27.4 provides that the phase out should "preferably" be performed in a progressive manner. The word "progressive" has been defined as "proceeding step by step, occurring one after another, successive".[227] Brazil argues, not without some reason, that the term "phase out" should not be interpreted to *require* the phased elimination of export subsidies when the subsequent clause indicates that phased elimination is not required but only preferred. Canada responds that the tension between these two phrases can be reconciled if the term progressive is defined, as in the context of tax rates, to mean that a Member should phase out its export subsidies "at an increasing pace". Under this interpretation, a developing country would be required to undertake a phased elimination of its export subsidies, and would be encouraged, but not required, to reduce its subsidies at an increasing rate.

7.80. The parties have in this dispute identified what could be viewed as an internal contradiction within the text of Article 27.4. Brazil suggests that the term "phase out" must be read in the context of the subsequent clause and thus not be interpreted to require phased elimination. This however requires ascribing to the term "phase out" a meaning which is more limited than its ordinary meaning. Canada on the other hand has suggested a reading of the text which would eliminate the contradiction, but which relies upon ascribing a highly particularised meaning to the word "progressive". In fact, although Canada indicates that "progressive" may mean "at an increasing rate", it cites no dictionary in support of that definition. Further, Canada has cited no logical reason why the drafters would express a non-binding preference for an end-loaded phased elimination of export subsidies by developing country Members. Rather, given that the object and purpose of the SCM Agreement is to impose multilateral disciplines on trade-distorting subsidization, one would expect that any preference would be for a front-loaded, rather than an end-loaded, phase-out. Accordingly, the Canadian interpretation would have us ascribe a special meaning to the term "progressive" without any support, either direct or circumstantial, that the drafters so intended. Thus, neither the Canadian nor the Brazilian approach is entirely satisfactory from a legal perspective.[228]

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[226] *Webster's Third International Dictionary.*

[227] *Shorter Oxford English Dictionary* (third edition).

[228] Although neither party has referred to the Spanish or French texts, we note that they would tend to support the Brazilian interpretation. Thus, the Spanish text provides that "Los países en desarollo Miembros a que se refiere el páraffo 2 b) eliminarán sus subvenciones a la exportación dentro del mencionado período de ocho años, preferentamente de manera progressiva." The French text provides that "Tout pays en développement Membre visé au paragraphe 2 b) supprimera ses subventions à la exportation dans le délai de huit ans, de préference de façon progressive." The terms "eliminarán" and "supprimera" do not bear the suggestion of "phased elimination" suggested by the English term "phase out".

7.81. Although the issue identified above is an interesting and complex one, we do not consider that we need resolve it in the context of this dispute. In our view, even if the term "phase out" does require the phased elimination of export subsidies by a developing country Member within the eight-year period, it does not specify in how many phases the elimination should be carried out, what the time-period between these phased reductions should be, and how these phased reductions should be distributed within the eight-year period.[229] We acknowledge that Brazil has not to date carried out any phased reductions in the level of its export subsidies, and that there is nothing in the record indicating that Brazil at the moment has any intention to do so. Thus, it may be said that it is possible, or even highly likely, that Brazil will not engage in phased reductions in its export subsidies within the eight-year period. Nevertheless, we cannot preclude that Brazil will engage in phased reductions between now and 31 December 2002. Accordingly, we cannot conclude on the basis of Brazil's actions in the first four years since the date of entry into force of the WTO Agreement that Brazil has failed to comply with the phase-out requirement of Article 27.4 by reason of a failure to undertake phased reductions within the eight-year transition period.[230]

7.82. The question remains whether Brazil has failed to comply with the phase-out requirement of Article 27.4 by reason of an alleged failure to eliminate its export subsidies by the end of the eight-year period. In this respect, Canada submits that PROEX does not have a termination date; that the financing period provided for regional aircraft under PROEX interest rate equalization is from ten to fifteen years; and that various purchasers have firm orders or options for aircraft to be delivered "well after 1 January 2003" on which they expect to receive PROEX payments. With respect to the latter contention, Canada cited a press report and a study indicating that at least one carrier benefiting from PROEX interest rate equalization is expected to continue taking delivery of Brazilian regional jets into the year 2004. Canada further argues that, comparing EMBRAER's current firm orders and options to its production schedule, EMBRAER must be reserving delivery slots beyond 2002 for existing customers, and that, "to the extent that these airlines expect to receive PROEX export subsidies", Brazil is not complying with its obligation to phase out its export subsidies by the end of the eight-year period.

7.83. Turning first to Canada's argument that PROEX does not have a termination date, we do not consider that the absence of a termination date for PROEX demonstrates that Brazil is not in compliance with its obligation to eliminate its export subsidies by the end of the eight-year period. In this respect, we do not agree with Canada that,

> "in order to establish its conformity with the 'phase out' Brazil must, at the very least, demonstrate that it has put in place a programme or a schedule of phased reductions of its export subsidies, <u>with a view to elimination at the end of the grace period</u>."(emphasis in original).[231]

While developing country Members certainly would be well advised to plan as far as possible in advance for the elimination of their export subsidies, their failure to do so does not in itself demonstrate that the

[229] It is instructive in this respect to compare, for example, the highly detailed provisions regarding the phased integration into GATT 1994 of textile and clothing products in Article 2 of the Agreement on Textiles and Clothing.

[230] We note that the definition of "phase out" cited by Canada is "to bring gradually . . . out of use", and that gradually has been defined as taking place "by degrees, slowly progressive, not rapid, steep or abrupt". Canada deduces from this that Brazil's obligation is not only to "bring its export subsidies out of use in a phased manner" but also to show that it "does not intend to bring its subsidies to a 'rapid, steep or abrupt end' before the end of the eight-year period." We do not consider however that in the absence of more precise requirements we can reasonably infer into the term "phase out" any more than an obligation to bring one's export subsidies out of use in a phased manner.

[231] Canada answer to Panel question 49.

required elimination will not occur. Nor does the fact that PROEX interest rate equalization has been provided with respect to financing extending beyond the 31 December 2002 in our view warrant a different conclusion. As discussed in paragraph 7.72, above, we consider that a PROEX interest rate equalization subsidy is granted at the moment that title to the bonds relating to the equalization is transferred to the lender financial institution. Accordingly, the relevant question in our view is not whether bonds issued before the end of the transition period may be redeemed after the end of that period, but rather whether Brazil continues to issue new bonds – and therefore to grant further subsidies – after the end of the transition period. It is to this issue that we now turn.

7.84. As noted in paragraph 7.82 above, Canada relies upon a press report[232] and estimates in a study[233], as well as calculations based on EMBRAER's order book and production schedule, for the proposition that Brazil has already committed to provide PROEX interest rate equalization with respect to regional aircraft that will be delivered after 31 December 2002.[234] The most telling evidence is the press report, which states that "Eagle expects to take delivery of its first ERJ-135 in July of next year, and continue accepting airplanes through 2004". Brazil concedes that this transaction involves PROEX interest rate equalization.[235] Further, Brazil has argued forcefully that it is legally required, as of the date that it issues a letter of commitment to EMBRAER, to issue the bonds if the terms of the letter of commitment are respected.[236] Because, under the PROEX interest rate equalization scheme, bonds relating to an export transaction are not issued until it has been confirmed that an export transaction will in fact occur,[237] this strongly suggests that Brazil will continue to issue bonds – and hence to grant new subsidies – after 31 December 2002. Accordingly, Canada has established in our view that Brazil will continue to issue bonds, and thus to grant PROEX interest rate equalization subsidies – although at a level which cannot be determined -- beyond 31 December 2002.

7.85. Is the foregoing demonstration sufficient to show, in advance, that Brazil has not complied with the condition of Article 27.4 that it "phase out its export subsidies within the eight-year period"? We consider that it is. It is true, as we stated above,[238] that the Committee on Subsidies and Countervailing Measures may extend the eight-year period, and that during the period of any such extension the Article 3.1(a) prohibition on export subsidies would continue to be inapplicable to the developing country Member in question. Brazil, however, has entered into a legally binding commitment to issue bonds where certain conditions are met without having yet even requested an extension of that period. Further, we note that this commitment has had an effect on the marketplace by allowing EMBRAER to conclude export contracts for deliveries of regional aircraft to occur, and for subsidies to be granted, after the end of that period. Accordingly, we must conclude on the facts before us that Brazil has not complied with its obligation to phase out its export subsidies by the end of the transition period.

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[232] *See American Eagle to Replace Aging Saabs with ERJ-135s*, in *Flight International*, 1 October 1998 (Canada exhibit 71).

[233] *See* Canada exhibit 64.

[234] Although this evidence may be less than conclusive, we consider it sufficient to raise a presumption that Canada's factual assertion is correct, particularly in light of the fact that access to definitive information on this issue is in the sole possession of Brazil and the companies in question, and that Brazil has at no point not contested the accuracy of Canada's assertions in this regard.

[235] *See* Brazil submission "Comments on Additional Information Submitted by Canada", paragraph 26.

[236] According to a written legal opinion submitted by Brazil to the Panel, "it is our opinion that, within the validity period of the letters of commitment and provided there are no pending debts from the exporter to the GOB, it is illegal and not viable the cancellation or the revoking of the interest rate equalization concessions made for the referred to transactions." *Legal Opinion from Professor Luiz Olavo Baptista*, Brazil exhibit 17.

[237] According to Brazil, where there is confirmation of the shipment of goods or the effective settlement of the relevant foreign exchange contract for the aircraft in question. *See* Brazil's answer to Panel question 28.

[238] Paragraph 7.82.

7.86. For the foregoing reasons, we find that Brazil has failed to comply with the condition of Article 27.4 relating to the phase out of its export subsidies.

5. Are Brazil's export subsidies "inconsistent with its development needs"?

7.87. Canada considers that, under the second sentence of Article 27.4, a developing country Member seeking to benefit from non-application of the Article 3.1(a) prohibition on export subsidies must demonstrate that its export subsidies are consistent with its development needs. Canada considers that this is not a self-judging provision, and that it should be applied on the basis of objective standards. Although Canada "does not propose to set out these standards", it does argue that one objective standard in this case consists of the domestic content standards established by Brazil with respect to PROEX. Specifically, Canada argues that with respect to regional aircraft Brazil has waived the domestic content rules generally applicable under PROEX and provides interest rate equalization on the full value of the aircraft in spite of the low domestic content of those aircraft. Canada argues that another relevant standard may be foreign exchange earnings versus foreign exchange expenditure on export subsidies.

7.88. Brazil argues that Article 27 presumes that export subsidies are consistent with a developing country Member's development needs. In support of this view, it cites Article 27.1 of the SCM Agreement, which provides that "Members recognize that that subsidies may play an important role in economic development programmes of developing country Members." Brazil further argues that the language of Article 27.4, which provides that export subsidies shall be eliminated in a period shorter than eight years "when the use of subsidies is inconsistent with" a developing country Member's development needs, clearly means that the burden is on the challenging Member to demonstrate the "inconsistency". Brazil rejects Canada's view that the waiver of certain domestic content regulations in the case of PROEX interest rate equalization payments for regional aircraft is relevant: Article 27 contains no domestic content requirement, and any standards applied with respect to this issue should in Brazil's view relate to the overall needs of the developing country Member, not to one particular industry or economic sector. Finally, Brazil asserts on the basis of certain information regarding economic conditions and the importance of an open, export-oriented economy that PROEX is in fact consistent with its development needs.

7.89. In considering this issue, we note that this element of Article 27.4 is troubling from the perspective of a panel. Article 27.4 provides in relevant part that a developing country Member "shall eliminate [its export subsidies] within a period shorter than that provided for in this paragraph when the use of such export subsidies is inconsistent with its development needs." We recognize that as written this clause is mandatory, and a conclusion that this clause was not susceptible of application by a panel would be inconsistent with the principle of effective treaty interpretation. On the other hand, an examination as to whether export subsidies are inconsistent with a developing country Member's development needs is an inquiry of a peculiarly economic and political nature, and notably ill-suited to review by a panel whose function is fundamentally legal.[239] Further, the SCM Agreement provides panels with no guidance with respect to the criteria to be applied in performing this examination. We consider that it is the developing country Member itself which is best positioned to identify its development needs and to assess whether its export subsidies are consistent with those needs. Thus, in applying this provision we consider that panels should give substantial deference to the views of the developing country Member in question.

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[239] It may be noted that under Article 27.14, "[t]he Committee [on Subsidies and Countervailing Measures] shall, upon request by an interested Member, undertake a review of a specific export subsidy practice of a developing country Member to examine whether the practice is in conformity with its development needs." In our view, a body such as the Committee is far better equipped to perform this type of examination than is a panel.

7.90. As discussed above, we consider that Canada bears the burden of demonstrating that, because Brazil has not complied with the conditions set forth in Article 27.4, the Article 3.1(a) prohibition on export subsidies applies to Brazil. Further, we note that Article 27.4 does not provide that a developing country Member must eliminate its export subsidies in a period shorter than eight years *unless* the use of such export subsidies *is consistent* with its development needs. Rather, it provides that a developing country Member must eliminate its export subsidies in a period shorter than eight years *if* the use of such export subsidies is *inconsistent* with its development needs. Thus, in order to prevail on this issue Canada must present evidence and argument sufficient to raise a presumption that the use of export subsidies by Brazil is inconsistent with Brazil's development needs.

7.91. Canada argues that PROEX payments on exports of regional aircraft are inconsistent with Brazil's development needs because Brazil has waived certain domestic content rules generally applicable under PROEX in the context of the export of such regional aircraft. Specifically, Canada asserts that under PROEX regulations, exports with a domestic content index of 60 per cent or more are subject to interest rate equalization payments on 100 per cent of their value, while for goods with a domestic content index of less than 60 per cent, the percentage eligible for interest rate equalization is reduced according to a formula. Canada asserts that the ERJ-145 regional jet, for example, has a domestic content index of approximately 15 per cent, and thus should be eligible for interest rate equalization on only 55 per cent of its value, but that it in fact benefits from 100 per cent equalization. Canada further notes that the spare parts may make up as much as thirty per cent of the value of the export package, and that these spare parts could have no Brazilian content whatsoever. Brazil has not contested Canada's calculations of the Brazilian value-added of the ERJ-145, nor its characterization of PROEX domestic content rules.[240]

7.92. It is not entirely clear whether under Article 27.4 it is a particular export subsidy practice or a Member's export subsidies generally which must be shown to be inconsistent with its development needs.[241] Even if we assume that it is appropriate to review whether a particular subsidy practice with respect to a particular product is inconsistent with a developing country Member's development needs, we do not believe that the evidence submitted by Canada is sufficient to raise a presumption that PROEX payments on regional aircraft are inconsistent with Brazil's development needs. In our view, the fact that Brazil has a generally applicable rule regarding the relationship between the domestic content of an exported product and the extent of the PROEX interest rate equalization available with respect to that product does not mean that the deviation from that rule in a particular case is necessarily inconsistent with a developing country Member's development needs. Nor do we see any basis to conclude that PROEX payments on regional aircraft are necessarily inconsistent with Brazil's development needs merely because the Brazilian value-added of the aircraft being exported is relatively low. There could be any number of reasons why the provision of export subsidies might be consistent with a Member's development needs in such a case. For example, a developing country Member might be interested in the possible technological spin-off effects from the development and production of the product in question, or

[240] Canada's calculations appear to be based on a study performed by Ernst and Young on behalf of Canada entitled *Analysis of EMBRAER's Use of the Brazilian Export Financing Program PROEX*. Although Canada did not submit this study into evidence, Brazil submitted it as exhibit 9 to support certain arguments of its own. On the basis of this study (p. 18), it appears that the domestic content figure cited by Canada in fact referred to the ERJ-135 (with an estimated Brazilian value-added of 14.8 per cent) rather than to the ERJ-145 (with an estimated Brazilian value-added of 26.1 per cent). We note however that business confidential documents submitted by Brazil indicate that in the view of the Bank of Brazil the domestic content of the ERJ-145 is substantially higher than estimated by Canada.

[241] Article 27.14 envisions the review by the Committee of whether a "specific export subsidy practice" by a developing country Member is in conformity with its development needs. This language differs notably from that of Article 27.4, which refers merely to "such export subsidies", with "such" presumably referring back to the export subsidies whose level a Member is not to increase (and recalling that, in this case at least, the "level of export subsidies" is being examined in terms of the overall level of export subsidies being provided by Brazil).

the need to establish a strong market presence and reputation in foreign markets as a stepping stone to introducing products with greater national value-added. In fact, Canada has not made any meaningful effort to relate the issue of Brazilian value-added to the broader issue of Brazilian development needs.[242]

7.93. For the foregoing reasons, we conclude that Canada has failed to present evidence and argument sufficient to raise a presumption that the use of export subsidies by Brazil is inconsistent with Brazil's development needs.

VIII. CONCLUSIONS AND RECOMMENDATION

8.1. In conclusion, we find that:

(a) PROEX interest rate equalization payments on exports of Brazilian regional aircraft are subsidies within the meaning of Article 1 of the SCM Agreement which are contingent upon export performance within the meaning of Article 3.1(a) of that Agreement;

(b) PROEX interest rate equalization payments on exports of Brazilian regional aircraft are not "permitted" by reason of the first paragraph of item (k) of the Illustrative List of Export Subsidies;

(c) Brazil has failed to comply with certain of the conditions of Article 27.4 of the SCM Agreement and the prohibition of Article 3.1(a) of the SCM Agreement is therefore applicable to Brazil.

8.2. Accordingly, we find that payments on exports of regional aircraft under the PROEX interest rate equalization scheme are export subsidies inconsistent with Article 3 of the SCM Agreement.

8.3. Pursuant to Article 3.8 of the DSU, the finding in paragraph 8.2 also constitutes a case of *prima facie* nullification or impairment of benefits accruing to Canada under the SCM Agreement, which Brazil has not rebutted.

8.4. Canada has requested that the Panel make specific recommendations regarding implementation of these findings. We consider however that we are required to make the recommendation provided for in Article 4.7 of the SCM Agreement and are authorized to make no other. Accordingly, we recommend that Brazil withdraw the subsidies identified above without delay.

8.5. Article 4.7 further provides that "the panel shall specify in its recommendation the time-period within which the measure [i.e., the measure found to be a prohibited subsidy] must be withdrawn." Presumably, we are expected to take into account the nature of the measures and the difficulties likely to be faced in implementing the recommendation when specifying what period would represent withdrawal "without delay". We note, however, that there is no experience with respect to what steps could constitute "withdrawal" of the subsidies in various factual circumstances, and we do not consider that it is within our mandate to tell Brazil what steps are required in order to implement our recommendation. Accordingly, taking into account the nature of the measures and the procedures which may be required to implement our recommendation, on the one hand, and the requirement that Brazil withdraw its subsidies "without delay" on the other, we conclude that Brazil shall withdraw the subsidies within 90 days.

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[242] In light of our view that the evidence submitted by Canada is insufficient to raise a presumption that PROEX payments are inconsistent with Brazil's development needs, we need not consider Brazil's response to Canada's assertions.

ANNEX 1

PROCEDURES GOVERNING BUSINESS CONFIDENTIAL INFORMATION

AND DECLARATION OF NON-DISCLOSURE

PROCEDURES GOVERNING BUSINESS CONFIDENTIAL INFORMATION

I. BASIC PRINCIPLE

1. The treatment of information as Business Confidential under these procedures imposes a substantial burden on the Panel and the parties. The indiscriminate designation of information as Business Confidential could limit the ability of a party to fully include in its litigation team individuals who have particular knowledge and expertise relevant to presenting the party's case, impede the work of the Panel and complicate the Panel's task in formulating credible public findings and conclusions. Finally, the Panel recalls that all WTO Members are obliged under Article 25.9 of the SCM Agreement to provide information regarding the nature and extent of any subsidy "in a comprehensive manner" and with "sufficient details to enable the other Member to assess their compliance with the terms" of the SCM Agreement. Accordingly, while the Panel recognizes that the parties have a legitimate interest in protecting sensitive Business Confidential information, *the Panel expects that parties will exercise the utmost restraint in designating information as Business Confidential.*

II. DEFINITIONS

“approved person” means

i) a Panel member;
ii) a representative;
iii) a Secretariat employee; or
iv) a PGE member,

who has filed with the Chairman of the Panel a Declaration of Non-disclosure.

“conclusion of the Panel” means when, pursuant to DSU Article 16.4, the Panel report is;

i) adopted;
ii) not adopted; or
iii) the Panel report is appealed and the report of the Appellate Body is adopted.

“Business Confidential information” means any information that has been designated as Business Confidential by the party submitting the information, and that is not otherwise available in the public domain.

“Declaration of Non-disclosure” means a copy of the declaration set out in Annex II, signed and dated by the person making the declaration.

“designated as Business Confidential” means:

i) for printed information, clearly marked with the notation ‘BUSINESS CONFIDENTIAL INFORMATION’ and with the name of the party that submitted the document;

ii) for binary-encoded information, clearly marked with the notation ‘BUSINESS CONFIDENTIAL INFORMATION’ on a label on the storage medium, and clearly annotated with the notation ‘BUSINESS CONFIDENTIAL INFORMATION’ in the binary-encoded files; and

iii) for uttered information, declared by the speaker to be "Business Confidential information" prior to the disclosure.

"dispute" means Canada's challenge to certain Brazilian measures under Article 4 of the WTO Agreement on Subsidies and Countervailing Measures, WT/DS46, entitled "Brazil – Export Financing Programme for Aircraft".

"DSU" means the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes.

"Geneva mission" means the buildings and grounds of Brazil and Canada at Ancienne Route 17B, 1218 Grand-Saconnex and Rue du Pré-de-la-Bichette 1, 1202 Geneva, respectively.

"information" means:

i) printed information;
ii) binary-encoded information stored in computer diskettes, computer disc drives, CD roms, or other electronic media; or
iii) uttered information,

including without limiting the generality of the foregoing, offers, agreements, reports, forecasts, compilations, studies, plans, presentations, charts, graphs, pictures and drawings.

"Panel" means the WTO panel established pursuant to DSU Article 6 by the 23 July 1998 decision of the WTO Dispute Settlement Body to examine the dispute.

"Panel meeting" means a substantive meeting of the Panel with the parties or the interim review meeting of the Panel with the parties, as described in the working procedures of DSU Appendix 3.

"Panel member" means a person selected pursuant to DSU Article 8 to serve on the Panel.

"Panel process" means the process of the Panel as described in DSU Articles 12, 15 and 16, until and including the conclusion of the Panel.

"party" means Brazil or Canada.

"PGE member" means a person appointed to the Permanent Group of Experts established pursuant to SCM Agreement Article 24, and who has been requested to assist the Panel pursuant to Article 4.5 of the SCM Agreement.

"premises of the WTO" means buildings and grounds of the WTO at Centre William Rappard, Rue de Lausanne 154, Geneva, Switzerland.

"representative" means:

i) an employee of a party;
ii) an agent for all purposes of a party; or
iii) a legal counsel or other advisor of a party,

who has been authorized by a party to act on behalf of such party in the course of the dispute and whose authorization has been notified to the Chairman of the Panel and to the other party, but in no circumstances shall this definition include an employee, officer or agent of a private company engaged in aircraft manufacturing.

"SCM Agreement" means the WTO *Agreement on Subsidies and Countervailing Measures.*

"Secretariat" means the Secretariat of the World Trade Organization.

"Secretariat employee" means a person employed or appointed by the Secretariat who has been authorized by the Secretariat to work on this dispute and whose authorization has been notified to the Chairman of the Panel, including without limiting the generality of the foregoing, translators and transcribers present at the Panel hearings.

"secure location" means a locked storage receptacle on the premises of the WTO chosen by the Secretariat to provide secure storage for Business Confidential information.

"submit" means:

i) the filing by a party of printed or binary-encoded information at the Secretariat during the dispute;

ii) the filing by a party of printed or binary-encoded information with the Panel during a Panel hearing; or

iii) the uttering of information during a Panel hearing.

"third party" means a Member having notified its interest in the dispute to the DSB pursuant to DSU Article 10.

III. SCOPE

1. These procedures apply to all Business Confidential information submitted during the Panel process.

IV. OBLIGATION ON PARTIES

1. Each party shall ensure that its representatives comply with these procedures.

V. SUBMISSION BY A PARTY

1. When submitting information, a party may designate all or any part or parts of that information as Business Confidential information. Business Confidential information shall be submitted in two copies: one copy of the Business Confidential information shall be submitted to the Secretariat; the other copy of the Business Confidential information shall be submitted to the other party at its Geneva mission.

2. If, taking into the account the Basic Principle stated in Article I, the Panel considers that a party has designated as Business Confidential information which is not reasonably entitled to such treatment, the Panel may decline to consider such information. In such a case, the party submitting the information may, at its discretion:

i) withdraw the information, in which case the Panel and the other party shall promptly return the information to the party submitting it; or

ii) withdraw the designation of the information as Business Confidential.

3. When submitting printed or binary-encoded Business Confidential information, the party shall also provide:

i) a non-Business Confidential edited version, redacted in such a manner as to convey a reasonable understanding of the substance of the information;

ii) a non-Business Confidential summary in sufficient detail to convey a reasonable understanding of the substance of the information; or

iii) in exceptional circumstances, a written statement:

(a) that such a non-Business Confidential edited version or non-Business Confidential summary cannot be made, or

(b) that such a non-Business Confidential edited version or non-Business Confidential summary would disclose facts that the party has a proper reason for wishing to keep business confidential.

4. If the Panel considers that a non-Business Confidential edited version or summary does not fulfill the requirements of paragraph 3(i) or (ii), or that such exceptional circumstances as justify a statement pursuant to paragraph 3(iii) do not exist, the Panel may decline to consider the Business Confidential information in question. In such a case, the party submitting the information may, at its discretion,

i) withdraw the information, in which case the Secretariat and the other party shall promptly return the information to the party submitting it; or

ii) comply with the provisions of paragraph 3 to the satisfaction of the Panel.

5. When uttering Business Confidential information at a Panel meeting, the speaker shall also provide a brief non-Business Confidential oral statement in sufficient detail to convey a reasonable understanding of the substance of the information that will be uttered.

VI. STORAGE

1. The Secretariat shall store all Business Confidential information submitted in the secure location when not in use by an approved person.

2. Each party shall store all Business Confidential information submitted to it by the other party in a safe in a locked room at the premises of its Geneva mission, when not in use by a representative. Only a representative shall be given authority to unlock the locked room containing the safe, and the locked safe. If requested, either party may visit the other party's Geneva mission to review the proposed location of the safe, and to propose any changes. Any disagreements between the parties regarding the location of the safe, or any other aspect related to the safeguarding of the Business Confidential information will be decided by the Panel.

3. An approved person shall take all necessary precautions to safeguard Business Confidential information when in use.

VII. OBLIGATION NOT TO DISCLOSE

1. Where Business Confidential information has been submitted pursuant to these procedures, no approved person who views or hears such information shall disclose that information, or allow it to be disclosed, to any person other than another approved person, except in accordance with these procedures.

2. The Panel shall not disclose Business Confidential information in its interim and final reports, but may make statements of conclusion drawn from such information.

VIII. DISCLOSURE

1. The Secretariat shall make available for viewing or hearing only on the premises of the WTO any Business Confidential information requested by an approved person.

2. Each party shall promptly, and in a convenient manner, make available for viewing on the premises of its embassy or other diplomatic mission in the capital of the other party or, at the request of a approved person, on the premises of its embassy or other diplomatic mission at some other location, any Business Confidential information requested by an approved person.

3. Business Confidential information stored at the Geneva mission of a party may only be viewed by a representative of that party.

4. An approved person viewing or hearing Business Confidential information may take written summary notes of that information for the sole purpose of the Panel process.

5. Business Confidential information shall not be copied, distributed, or removed from the premises of the WTO, or from the premises of a party's Geneva mission, or from the premises of the embassy or other diplomatic mission referred to in paragraph 2, except as specifically provided in these Procedures.

6. Notwithstanding paragraph 5. above, a Panel member may remove a copy of Business Confidential information from the premises of the WTO. Any copies of Business Confidential information removed from the premises of the WTO by a Panel member shall be used exclusively by that Panel member for the purpose of working on the dispute, and shall be returned to the Secretariat upon conclusion of the Panel. Copies of Business Confidential information removed from the premises of the WTO by a Panel member shall be stored in a locked receptacle.

IX. DISCLOSURE AT A PANEL MEETING

1. A party that wishes to submit Business Confidential information during a Panel meeting may request the Panel to exclude persons who are not approved persons from the meeting. The Panel shall exclude such persons from the meeting for the duration of the submission of such information.

X. DISCLOSURE TO THIRD PARTIES

1. Article 10.3 of the DSU provides that "[t]hird parties shall receive the submissions of the parties to the dispute to the first meeting of the panel." Accordingly, disclosure shall be granted to representatives of third parties of Business Confidential information contained in the first submissions of the parties on the premises of the WTO, or on the premises of an embassy or other diplomatic mission of the party submitting the Business Confidential information consistent with Section VIII, paragraph 2. The provisions of these procedures shall apply *mutatis mutandis* to any such disclosure.

XI. TAPES AND TRANSCRIPTS

1. Any tapes and transcripts of Panel meetings at which Business Confidential information is uttered shall be treated as Business Confidential information under these procedures.

XII. RETURN AND DESTRUCTION

1. At the conclusion of the Panel the Secretariat and the parties shall:

   i) return any printed or binary-encoded Business Confidential information in their possession to the party that submitted such Business Confidential, unless that party agrees otherwise; and

   ii) destroy all tapes and transcripts of the Panel hearings that contain Business Confidential information, unless the parties mutually agree otherwise.

2. If the Panel Report is appealed, the Secretariat shall transmit any printed or binary encoded Business Confidential information, plus all tapes and transcripts of the Panel hearings that contain Business Confidential information, to the Appellate Body as part of the record of the Panel proceedings. The Secretariat shall transmit such information to the Appellate Body separately from the rest of the record and shall inform the Appellate Body of the special procedures that the Panel has applied with respect to such Business Confidential information. The parties shall comply with any directive of the Appellate Body regarding disclosure of Business Confidential information to parties or third parties as the Appellate Body may deem appropriate.

DECLARATION OF NON-DISCLOSURE

In accordance with the Procedures Governing Business Confidential information contained Annex I to the Working Procedures of the Panel on Brazil – Export Financing Programme for Aircraft (the Procedures), I agree to the following:

Words defined in the procedures have the same meaning in this Declaration of Non-Disclosure as in the Procedures.

1. I acknowledge having received a copy of the Procedures, a copy of which is attached.

2. I acknowledge having read and understood the Procedures.

3. I agree to be bound by, and to adhere to, the provisions of the Procedures and, accordingly, without limitation, to treat confidentially all Business Confidential information that I may view or hear from time to time in accordance with the Procedures.

Executed on this __________ day of ____________, 1998.

BY: __________________________
Name:

Title:

(Advisors only) Affiliation or employment:

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