BRAZIL - EXPORT FINANCING PROGRAMME FOR AIRCRAFT

Recourse by Canada to Article 21.5 of the DSU

Report of the Panel
WT/DS46/RW

Adopted by the Dispute Settlement Body
on 4 August 2000
as Modified by the Appellate Body Report

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I. PROCEDURAL BACKGROUND

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

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

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

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

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

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

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

1.7 The Panel was composed as follows:
Chairperson: Dr. Dariusz Rosati
Members: Prof. Akio Shimizu
Mr. Kajit Sukhum

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

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

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

II. FACTUAL ASPECTS

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

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

2.3 The financing terms for which interest rate equalisation payments are made are set by Ministerial Decrees. The terms, determined by the product to be exported, vary normally from one year to ten years. In the case of regional aircraft, however, this term has often been extended to 15 years, by waiver of the relevant PROEX guidelines. The length of the financing term, in turn, determines the spread to be equalised: the payment ranges from 0.5 percentage points per annum, for a term of up to six months, to 2.5 percentage points per annum, for a term of nine years or more.[5] The spread is fixed and does not vary depending on the lender's actual cost of

[1] Panel Report, *Brazil - Export Financing Programme for Aircraft* ("*Brazil - Aircraft*"), WT/DS46/R, adopted 20 August 1999, DSR 1999:III, 1221, paras. 2.1-2.6.
[2] As of the date of Canada's request for the matter of implementation to be referred to the original panel, the relevant legal instrument was Provisional Measure 1892-33 of 23 November 1999.
[3] Law No. 8187 of 1 June 1991, replaced by Provisional Measure No. 1629 of 12 February 1998.
[4] *See*, for example, Resolution No. 2380 of 25 April 1997.
[5] *See* Central Bank of Brazil Circular Letter No. 2881 of 19 November 1999.

funds.[6] As discussed in Section VI of this Report, Resolution No. 2667 of 19 November 1999 provides that, in respect of regional aircraft financing, "equalisation rates shall be established on a case by case basis and at levels that may be differential, preferably based on the United States Treasury Bond 10-year rate, plus an additional spread of 0.2% per annum, to be reviewed periodically in accordance with market practices."

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

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

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

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

III. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES

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

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

IV. ARGUMENTS OF THE PARTIES AND THIRD PARTIES

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

4.2 In addition, both parties have incorporated by reference their arguments in the original dispute with reference to whether the first paragraph of item (k) of the Illustrative List may be used to establish that an export subsidy is "permitted" and whether payments under PROEX are "payments" within the meaning of the first paragraph of item (k) of the List.[7]

V. INTERIM REVIEW

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

[7] Original panel report, *Brazil - Aircraft, supra*, footnote 1, paras. 4.53-4.71 and paras. 4.72-4.78, respectively.

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

5.3 With reference to Brazil's argument that its interpretation of item (k) was not confined to the scope of footnote 5, we note that, in the original dispute, Brazil's arguments appeared to evolve over time.[9] In Brazil's first submission in the original dispute, the focus of Brazil's arguments was not on footnote 5.[10] However, in its second submission in the original dispute, Brazil argued that the "material advantage" clause fell within the scope of footnote 5.[11] Brazil has not, however, limited its arguments regarding the interpretation of item (k) to the scope of footnote 5, and we have, therefore, made appropriate modifications to paragraph 6.41 of this Report. In any event, as we have indicated in paragraph 6.41, we consider that footnote 5 controls the interpretation of item (k) with respect to when the Illustrative List can be used to demonstrate that a measure is not a prohibited export subsidy.

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

5.5 In respect of Brazil's comments regarding the Panel's reference to the cost of borrowing of banks, the Panel wishes to point out that paragraph 6.53 of this Report represents a discussion of the way in which developing-country governments can utilise commercial lenders rather than provide direct export credit financing. The Panel in fact paraphrases Brazil's own arguments as to the relative cost of different modalities of providing export credits.[12] In that context, it is clear that utilising commercial lenders would be less expensive than providing direct financing, because the government can take advantage of the lower cost of borrowing enjoyed by commercial lenders. Footnote 53 is merely an illustration of this fact. Paragraph 6.53 is in no

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

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

10 *See* original Panel Report, *Brazil - Aircraft, supra*, footnote 1, paras. 4.53-4.54.

11 Ibid., at para. 4.67.

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

sense intended to suggest that Brazil argues that it provides PROEX interest rate equalisation in order to meet competition from export credit financing provided by commercial banks. We have, therefore, made appropriate modifications to paragraph 6.53 of this Report.

VI. FINDINGS

A. Introduction and Claims of Canada

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

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

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

> *First*, Canada contends that Brazil cannot, consistent with the recommendation of the DSB, continue to issue NTN-I bonds pursuant to letters of commitment issued under PROEX as it existed prior to the end of the implementation period, *i.e.*, 18 November 1999. Brazil responds that the DSB's recommendation to withdraw the prohibited subsidy does not require it to cease issuing NTN-I bonds pursuant to such pre-existing letters of commitment.
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> *Second*, Canada contends that payments in respect of regional aircraft pursuant to PROEX as modified by Brazil continue to be subsidies contingent upon export performance within the meaning of Article

[13] Appellate Body Report, *Brazil - Export Financing Programme for Aircraft* ("*Brazil - Aircraft*"), WT/DS46/AB/R, adopted 20 August 1999, DSR, 1999:III, 1161, para. 197. ("Appellate Body Report").

3.1(a) of the *SCM Agreement* and thus prohibited. Brazil responds that under PROEX as modified payments no longer are "used to secure a material advantage in the field of export credit terms" and therefore are "permitted" by the *SCM Agreement*.

We will take up each of these issues in turn.

B. May Brazil Continue to Issue NTN-I Bonds Pursuant to Letters of Commitment Issued under PROEX as it Existed before 18 November 1999?

6.4 Canada claims that Brazil has failed to withdraw the export subsidies for regional aircraft under PROEX, because it continues to grant, through the issuance of NTN-I bonds, PROEX subsidies found to constitute prohibited export subsidies pursuant to commitments made prior to 18 November 1999, the date by which Brazil was required to withdraw the export subsidies in question. Brazil considers that, in fulfilling its pre-18 November 1999 commitments through the issuance of NTN-I bonds after that date upon the export of regional aircraft, it is "not creating new subsidies"[14] and therefore not acting in a manner inconsistent with its obligations under the *SCM Agreement*.

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

6.6 In Brazil's view, Canada has confused the finding of the Appellate Body as to when PROEX subsidies are granted for the purposes of Article 27.4 of the *SCM Agreement* with the issue of when PROEX subsidies come into existence within the meaning of Article 1 of that Agreement. Brazil considers that under Article 1 a subsidy shall be deemed to exist when there is a financial contribution by a government and a benefit is thereby conferred. In the case of PROEX subsidies, the benefit arises when Brazil makes a legally binding commitment to provide PROEX support.[15] Because the financial contribution must logically precede or coincide with the benefit, the financial contribution must be in the form of a potential direct transfer of funds. In the view of Brazil, an interpretation of Article 1 that resulted in the conclusion that PROEX subsidies come into existence only when aircraft are exported would render whole clauses of Part III of the *SCM Agreement* ("Actionable Subsidies") a nullity

[14] Second Submission of Brazil, para. 3.

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

because, although the impact of PROEX on the domestic industry of a competitor would be felt when Embraer obtains an order, no subsidy would exist and thus no countervailing measure be possible until the aircraft was exported. Finally, Brazil argues that it is legally obligated to issue bonds pursuant to letters of commitment issued prior to the date of implementation of the DSB's recommendations or be subject to damages for breach of contract.

6.7 In considering this issue, we first note that Brazil does not deny that it continues to issue NTN-I bonds in respect of commitments made prior to 18 November 1999. Further, Brazil has stated, in response to a question from the Panel, that Resolution 2667 does not modify pre-existing PROEX commitments pertaining to aircraft to be exported after 22 November 1999, the date of publication of Resolution 2667.[16] We recall that, in the original dispute, the Panel found that PROEX payments on exports of Brazilian regional aircraft were export subsidies prohibited by Article 3.1(a) of the *SCM Agreement*. This finding was upheld by the Appellate Body. We also recall that the DSB recommended, pursuant to Article 4.7 of the *SCM Agreement*, that Brazil "withdraw the [export] subsidies ... without delay".

6.8 The issue Canada has put before us is whether the continued issuance of NTN-I bonds in respect of commitments entered into prior to 18 November 1999, on terms found by the Panel and the Appellate Body to give rise to a prohibited export subsidy, is inconsistent with Brazil's obligation to withdraw the export subsidies in question. Thus, we need not for the purposes of this dispute develop a comprehensive understanding of the scope of the obligation to "withdraw" a prohibited subsidy. Rather, it suffices to conclude - and Brazil does not contest - that a Member cannot be deemed to have withdrawn prohibited subsidies if it has not ceased to act in a manner inconsistent with the *WTO Agreement* in respect of those subsidies. We are therefore of the view that the DSB's recommendation that Brazil withdraw the prohibited subsidies in question clearly includes an obligation on the part of Brazil to cease violating the *SCM Agreement* by the end of the implementation period in respect of the measures in question.[17]

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[16] Response of Brazil to Question 4 of the Panel.

[17] We are aware that a panel established under Article 21.5 of the *DSU* recently found that a recommendation to "withdraw" a prohibited subsidy under Article 4.7 of the *SCM Agreement* "is not limited to prospective action only but may encompass repayment of the prohibited subsidy." Panel Report, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather - Recourse to Article 21.5 of the DSU by the United States (*"*Australia - Automotive Leather II (Article 21.5 - US)*"), WT/DS126/RW, adopted 11 February 2000, DSR 2000:III, 1189, para. 6.39. In that dispute, which involved one-time subsidies paid in the past whose retention was not contingent upon future export performance, the United States as complainant argued that the "prospective portion" of the subsidy granted by Australia, *i.e.*, $A26 million out of a total grant of $A30 million, had to be repaid. In this dispute, Canada has not claimed that the non-repayment, in whole or in part, of subsidies granted by Brazil represents a failure to "withdraw" the prohibited export subsidies in question. We recall that, under Article 3.7 of the *DSU*, the aim of the dispute settlement mechanism is to secure a positive resolution to a dispute, and that our role under Article 21.5 is to render a decision "where there is disagreement" as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations or rulings of the DSB. Accordingly, we shall address only claims that are put before us. Our silence on issues that are not before us should not be taken as expressing any view, express or implied, as to whether or not a recommendation to "withdraw" a prohibited subsidy may encompass repayment of that subsidy.