WORLD TRADE ORGANIZATION

Dispute Settlement Reports

2000
Volume IX

Pages 4091-4589

CAMBRIDGE
UNIVERSITY PRESS

PUBLISHED BY THE PRESS SYNDICATE OF THE UNIVERSITY OF CAMBRIDGE
The Pitt Building, Trumpington Street, Cambridge, United Kingdom

CAMBRIDGE UNIVERSITY PRESS
The Edinburgh Building, Cambridge CB2 2RU, UK
40 West 20th Street, New York, NY 10011–4211, USA
477 Williamstown Road, Port Melbourne, VIC 3207, Australia
Ruiz de Alarcón 13, 28014 Madrid, Spain
Dock House, The Waterfront, Cape Town 8001, South Africa

http://www.cambridge.org

Printed in the United Kingdom at the University Press, Cambridge

French edition and Spanish edition paperbacks of this title are both available directly from WTO Publications, World Trade Organization, Centre William Rappard, 154 rue de Lausanne, CH-1211 Geneva 21, Switzerland http://www.wto.org

ISBN 0 521 82855 4 hardback

THE WTO DISPUTE SETTLEMENT REPORTS

The *Dispute Settlement Reports* of the World Trade Organization (the "WTO") include panel and Appellate Body reports, as well as arbitration awards, in disputes concerning the rights and obligations of WTO Members under the provisions of the *Marrakesh Agreement Establishing the World Trade Organization*. The *Dispute Settlement Reports* are available in English, French and Spanish. Starting with 1999, the first volume of each year contains a cumulative index of published disputes.

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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

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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.
>
> *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.

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

> "A Member shall neither grant nor maintain subsidies [contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I]."

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

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

> "We agree with the Panel that 'PROEX payments may be 'granted' where the unconditional legal right of the beneficiary to receive the payments has arisen, even if the payments themselves have not yet occurred.' We also agree with the Panel that the export subsidies ... have not yet been 'granted' when the letter of commitment is issued, because, at that point, the export sales contract has not yet been concluded and the export shipments have not yet occurred. For the purposes of Article 27.4, we conclude that the export subsidies ... are 'granted' when all the legal conditions have been fulfilled that entitle the beneficiary to receive the subsidies. We share the Panel's view that such an unconditional legal right exists when the NTN-I bonds are issued."[18]

6.11 We note that Article 3.2 and Article 27.4 are provisions of the same Agreement. Further, both provisions relate to the prohibition on export subsidies set out under that Agreement. We do not perceive any basis to attribute to the term "grant" as used in Article 3.2 of the *SCM Agreement* a meaning different from that attributed to that term by this Panel and the Appellate Body as used in Article 27.4 of the *SCM Agreement*. It follows that the issuance of NTN-I bonds by Brazil constitutes the granting of export subsidies within the meaning of Article 3.2.

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

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

[18] Appellate Body Report, *Brazil - Aircraft*, *supra*, footnote 13, para. 158.

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

> "In our view, the Panel reached the correct conclusion. However, it did so on the basis of faulty reasoning. The issue in this case is when the subsidies for regional aircraft under PROEX should be considered to have been "granted" *for the purposes of calculating the level of Brazil's export subsidies under Article 27.4 of the SCM Agreement.* The issue is *not* whether or when there is a "financial contribution", or whether and when the subsidy "exists", within the meaning of Article 1.1 of that Agreement."(emphasis in original.)[19]
>
> The Appellate Body further explained that:
>
> "[T]he issue before the Panel under the heading 'Has Brazil increased the level of its export subsidies?' was simply this: given that the export subsidies in this case were already deemed to 'exist', when were they 'granted'? At issue was the interpretation and application of Article 27.4, *not* of Article 1 ... [F]or the purposes of Article 27.4, we see the issue of the *existence* of a subsidy and the issue of the point at which that subsidy is *granted* as two legally distinct issues (emphasis in original). Only one of those issues is raised here and, therefore, must be addressed".[20]

6.14 We recognize that the distinction made by the Appellate Body was between the existence of a subsidy and when a subsidy is granted related to when a subsidy is granted *for the purposes of Article 27.4* of the *SCM Agreement*, and not when it was granted *for the purposes of Article 3.2*. As a matter of logic, however, we cannot perceive - nor has Brazil identified - any basis for us to conclude that, while the existence of a subsidy is a legally distinct issue from when it is granted for the purposes of Article 27.4, it is *not* a legally distinct issue from when it is granted for the purposes of Article 3.2. In other words, if the issue of when a subsidy is "granted" *for the purposes of Article 27.4* is legally distinct from when it "exists" for the purposes of Article 1, then it follows that the issue of when a subsidy is granted *for the purposes of Article 3.2* is also legally distinct from the issue when it is exists for the purposes of Article 1. Accordingly, we decline Brazil's invitation to consider when the subsidy "exists" within the meaning of Article 1 when examining when the subsidy is "granted" for the purpose of Article 3.2.[21]

6.15 Brazil contends that requiring Brazil to cease issuing NTN-I bonds pursuant to commitments made prior to 18 November 1999 amounts to a retroactive remedy.

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[19] Ibid., para. 154.

[20] Ibid., para. 156.

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

We cannot agree. In our view, the obligation to cease performing illegal acts in the future is a fundamentally prospective remedy.[22]

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

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

C. Are Payments Pursuant to the PROEX Scheme as Modified by Brazil Consistent with the SCM Agreement*?*

6.18 In the first section of this Report, we addressed the *existence* of measures taken to comply with the recommendation of the DSB in respect of payments on

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

[23] A resolution of the question whether Brazil would be liable to damages for breach of contract for failure to issue NTN-I bonds in respect of existing commitments would require consideration not only of Brazilian administrative and contract law, but also of the role of the *WTO Agreement* in Brazil's domestic legal system. *See* Response of Brazil to Question 12 of the Panel. Although a Panel may examine municipal law in order to determine whether a Member has complied with the *WTO Agreement,* (*See, e.g.,* Report of the Appellate Body, *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products* ("*India – Patents (US)*"), WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I, 9, para. 66), we are reluctant to enter into such an examination here, as the issues are complex, not fully briefed, and ultimately not essential to our resolution of the case at hand. In any event, we recall that, under Article 27 of the *Vienna Convention on the Law of Treaties,* a party to a treaty may not invoke the provisions of its internal law as justification for its failure to perform a treaty.

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

1. Steps Taken by Brazil to Comply with the Recommendation of the DSB

6.19 The basic language authorising PROEX interest rate equalisation, found in Provisional Measure 1892-33, has not changed since the date of establishment of the original panel in this dispute.[24] Brazil however argues that it has implemented the DSB's recommendation in this dispute through Resolution 2667 of 19 November 1999.[25] Article 1 of the Resolution repeats the basic standard of Provisional Measure 1892-33 that the National Treasury may grant equalisation sufficient "to ensure that the relevant financial charges are consistent with standard practices on the international market." Article 1 further provides that:

> "Paragraph 1. In the financing of aircraft exports for regional aviation markets, equalisation rates shall be established on a case by case basis and at levels that may be differential, preferably based on the United States Treasury Bond 10-year rate, plus an additional spread of 0.2% per annum, to be reviewed periodically in accordance with market practices.
>
> Paragraph 2. The equalisation rate shall be limited to the percentages established by the Central Bank of Brazil, and shall remain fixed throughout the period in question."

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

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

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

2. Assessment of the Panel

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

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

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

(a) May the First Paragraph of Item (k) be Used to Establish that an Export Subsidy is "Permitted"?

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

> "The grant by governments (or special institutions controlled by governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they

[26] Original panel report, *supra*, *Brazil - Aircraft*, footnote 1, para. 8.1.
[27] Appellate Body Report, *Brazil - Aircraft*, *supra*, footnote 13, para. 164.
[28] Original Panel Report, *supra*, footnote 1, para. 7.17.

> borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), *or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms*." (emphasis added).

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

(i) Has this Issue Already Been Addressed by the Appellate Body?

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

> "Nor do we opine on whether a 'payment' within the meaning of item (k) which is not 'used to secure a material advantage in the field of export credit terms' is, *a contrario*, 'permitted' by the *SCM Agreement*, even though it is a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) of that Agreement. The Panel did not rule on these issues, and the lack of Panel findings on these issues was not appealed."[30]

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

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

[30] Appellate Body Report, *Brazil – Aircraft*, *supra*, footnote 13, para. 187.

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

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

> "Except as provided in the Agreement on Agriculture, the following subsidies within the meaning of Article 1, shall be prohibited:
>
> (a) Subsidies contingent [footnote omitted], in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I[5];
>
> .....
>
> [5] Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

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

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

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

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

> "The Illustrative List does not deal with all possible financial contributions, but for those it does deal with, it establishes, by virtue of

> footnote 5, a dispositive legal standard insofar as prohibited subsidies are concerned."[31]

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

(iii) The Role of Footnote 5 to the SCM Agreement

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

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

Footnote 5 provides that:

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

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

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

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

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

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

(k) provides that such measures "shall not be considered an export subsidy prohibited by this Agreement". Arguably, footnote 5 in its ordinary meaning could extend more broadly to cover cases where the Illustrative List contains some other form of *affirmative* statement that a measure is not subject to the Article 3.1(a) prohibition, that it is *not* prohibited, or that it is allowed, such as, for example, the first and last sentences of footnote 59[34] and the proviso clauses of items (h)[35] and (i)[36] of the Illustrative List.[37]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(iv) The Material Advantage Clause and the Principle of Effective Treaty Interpretation

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

6.43 Let us consider the first situation envisioned by the first paragraph of item (k), the grant by governments of export credits at rates below their cost of funds. It may generally be assumed that in such circumstances there will be a benefit to the recipient and thus a subsidy. This is however not always the case. Whenever a government's cost of funds is higher than that of the borrower, a loan at below the government's cost of funds may nevertheless fail to confer a benefit on the recipient. For example, Brazil argues in this dispute that its cost of funds is in excess of 13 per cent. By contrast, it is likely that many purchasers of Brazilian exports could obtain private export credit financing, not benefiting from government intervention of any kind, at an interest rate significantly lower than 13 per cent. Thus, direct financing by Brazil in these circumstances could well entail a cost to the government but provide no advantage, material or otherwise, to the recipient. Under these circumstances, and in the absence of the material advantage clause, Brazil would be prohibited from providing export credits at an interest rate lower than 13 per cent[44], even if the export credits provided no advantage whatsoever.[45] The role of the material advantage clause in this situation is to narrow the scope of the *per se* prohibition in such cases.

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[43] The principle of effectiveness in the interpretation of treaties has been recognised in the WTO dispute settlement system. As the Appellate Body explained in *US - Gasoline*, "an interpreter is not free to adopt a reading that would result in reducing whole clauses or paras. of a treaty to redundancy or inutility" (Appellate Body Report, *United States - Standards for Reformulated and Conventional Gasoline ("US - Gasoline")*, WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3, footnote 10, at 21).

[44] Except to the extent it successfully invoked the second para. of item (k).

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

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

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

(v) Developing Countries and the Object and Purpose of the SCM Agreement

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

6.47 We agree with Brazil that the *SCM Agreement* should not be interpreted in a manner that provides special and *less* favourable treatment for developing country Members in the field of export credit terms if the text of the Agreement permits of an alternative interpretation. In particular, an interpretation of the *SCM Agreement* that allowed developed country Members to consistently offer export credit terms more favourable than those that could in practice be offered by developing country Members - at least as of the date the export subsidy prohibition applies to any given developing country Member[48] - would be at odds with one of the objects and purposes of the *WTO Agreement* generally and the *SCM Agreement* specifically.[49]

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

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

[48] In this respect, we recall that the prohibition on export subsidies does not apply to least-developed country Members, nor to Members listed in Annex VII until their GNP *per capita* reaches