

**ANNEX B**

**SUBMISSIONS OF BRAZIL**

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**ANNEX B-1**  
**FIRST SUBMISSION OF BRAZIL**

(16 March 2001)

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## I. INTRODUCTION

1. On 4 August 2000, the Dispute Settlement Body ("DSB") adopted the report of the Appellate Body in the previous Article 21.5 proceedings in this matter.<sup>1</sup> In its report, the Appellate Body found that Brazil had failed to establish that the steps it had taken to amend the measure at issue in this case, the *Programa de Financiamento às Exportações* (PROEX), brought that measure into conformity with the previous rulings and recommendations of the DSB. Accordingly, on 12 December 2000, Brazil advised the DSB of additional amendments to PROEX that it had taken to bring the measure fully into conformity with Brazil's obligations under the *Agreement on Subsidies and Countervailing Measures* (the "SCM Agreement" or "Agreement").

2. On 19 January 2001, Canada notified the DSB of its intention once again to seek recourse to Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") in these proceedings. Canada's decision not to seek consultations concerning the steps Brazil had taken to amend PROEX has meant that Brazil has not had an opportunity to explain the measure to Canada. At its meeting on 16 February 2001, the DSB referred the matter to the original Panel.

3. In this submission, Brazil will demonstrate first, that PROEX interest rate support payments for aircraft no longer constitute a subsidy within the meaning of Article 1 of the SCM Agreement. Assuming *arguendo*, however, that PROEX interest rate support payments are a subsidy within the meaning of Article 1, Brazil also will demonstrate that they are not prohibited by Article 3 because they comply with the interest rate requirements of the *Arrangement on Guidelines for Officially Supported Export Credits* of the Organization for Economic Cooperation and Development ("*OECD Arrangement*," or "*Arrangement*"). Therefore, they are eligible for the "safe haven" of the second paragraph of item (k) to Annex I of the Agreement. Further, even if PROEX interest rate support payments for aircraft are considered to be a subsidy, and, assuming also that they do not comply with the requirements of the second paragraph of item (k), they, nevertheless, are payments that are not used to secure a material advantage in the field of export credit terms within the meaning of the first paragraph of item (k), and, therefore, do not constitute a prohibited subsidy.

4. Brazil also will establish that the version of the *OECD Arrangement* that is relevant to these proceedings is the 1992 version that was in effect on 1 January 1995 when the *Marrakesh Agreement Establishing the World Trade Organization* ("Marrakesh Agreement" or "WTO Agreement") became effective. However, Brazil also will show that PROEX interest rate support payments for aircraft comply with both the 1992 version of the *Arrangement* that was in effect on 1 January 1995, and with the 1998 version, which is currently in effect.

## II. THE HISTORY OF THESE PROCEEDINGS

5. Before the original Panel and the Appellate Body, and also before the first Article 21.5 Panel, Brazil contended that – even though the initial PROEX and its first revised version, PROEX II, were subsidies contingent upon exports – they were not prohibited because they fell under the exception of the first paragraph of item (k), and did not confer a "material advantage" within the meaning of that paragraph. The Article 21.5 Panel, however, disagreed. It concluded that PROEX payments could not be said to constitute "the payment by [a government] of all or part of the costs incurred by exporters or financial institutions in obtaining [export] credits," as required by the first paragraph of item (k).<sup>2</sup> Further, it held that Brazil had not provided sufficient evidence that export credits at fixed interest rates in respect of regional aircraft were provided in the commercial market at the benchmark

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<sup>1</sup> Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU ("Original 21.5 Report"), WT/DS46/RW (9 May 2000).

<sup>2</sup> *Id.*, para. 6.72.

rate established by Brazil in PROEX II.<sup>3</sup> Finally, the Panel concluded that the first paragraph of item (k) "cannot be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1.(a) is 'permitted'."<sup>4</sup>

6. The Appellate Body agreed with the 21.5 Panel that "Brazil has failed to demonstrate that PROEX payments are not 'used to secure a material advantage in the field of export credit terms' within the meaning of the first paragraph of item (k)" of the Illustrative List of Export Subsidies.<sup>5</sup> Because that finding was sufficient to overcome Brazil's defense under the first paragraph of item (k), the Appellate Body found it unnecessary "to examine the issue of whether export subsidies under the revised PROEX are 'payments [by governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits' within the meaning of the first paragraph of item (k)."<sup>6</sup> The Appellate Body, however, stated that it "would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List" if Brazil had demonstrated that the payments under PROEX II were "payments" within the meaning of the first paragraph of item (k) and that they were not used to secure a material advantage.<sup>7</sup> In light of the rulings and recommendations of the DSB, Brazil has again revised PROEX.

### III. DESCRIPTION OF THE REVISED PROEX

7. On 6 December 2000, the Central Bank of Brazil adopted Resolution No. 002799, which "Modifies the applicable criteria for operations under the interest rate equalization system of the Export Finance Program – PROEX."<sup>8</sup> For convenience, the revised PROEX programme arising out of this resolution shall be referred to as "PROEX III." Article 1 of the Resolution states:

In export financing operations for goods and services, as well as for software, in compliance with Law 9,606, dated February 19, 1998, the National Treasury may provide to the finance or re-financing agency, as the case may be, equalization enough to render financing costs compatible with those practiced in the international market.

Regarding interest equalization for exports of regional jet aircraft, Article 1, paragraph 1 of the Resolution provides:

When financing exports of regional aviation aircraft, interest rate equalization shall be established on a case-by-case basis, at levels that may vary according to the characteristics of each operation, complying with the Commercial Interest Reference Rate (CIRR) published monthly by the OECD corresponding to the currency and maturity of the operation.

Even though Brazil, as a developing country, is not a member of the OECD and hence is not a party to the *Arrangement*, the Resolution commits Brazil to comply with the CIRR for transactions involving aircraft.

8. PROEX III interest rate equalization remains subject to the maximum percentages established by the Central Bank of Brazil in its Circular Letter No. 002881, dated 19 November 1999. Circular

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<sup>3</sup> *Id.*, para. 6.104.

<sup>4</sup> *Id.*, para. 6.67.

<sup>5</sup> Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU, AB-2000-3 ("Appellate Body 21.5 Report"), WT/DS46/AB/RW (21 July 2000), para. 77.

<sup>6</sup> *Id.*, para. 78.

<sup>7</sup> *Id.*, para. 80.

<sup>8</sup> The original Portuguese version and the official English translation of Resolution No. 002799 are attached as Exhibit Bra-1.

Letter No. 002881 sets the maximum allowable interest equalization payment at 2.5 percent.<sup>9</sup> This maximum amount is subject to the stipulation of Article 1, paragraph 1 of Resolution 00279 that interest rate equalization for regional aircraft must comply with the terms of the CIRR established under the *OECD Arrangement*.

9. In addition, PROEX III interest rate equalization remains subject to the requirement that interest rate equalization may be provided for only 85 percent of the value of the sale, pursuant to Article 5, paragraph 1 of Directive number 374 of the Ministry of Development, Industry, and Foreign Trade, dated 21 December, 1999.<sup>10</sup> Directive 374 also establishes a maximum financing term of 10 years for regional jet aircraft.<sup>11</sup>

#### IV. PROEX IS NOT A SUBSIDY WITHIN THE MEANING OF ARTICLE 1

10. The threshold issue for this Panel is whether PROEX III is an export subsidy within the meaning of Article 1 of the SCM Agreement. A negative answer to that question obviates any need to consider the measure under either paragraph of item (k).

11. A subsidy is a financial contribution by a government that confers a benefit. However, a financial contribution that does *not* confer a benefit is *not* a subsidy.<sup>12</sup> The Appellate Body has held that CIRR is a commercial rate.<sup>13</sup> Indeed, Canada itself – in a belated admission that "struck" the Panel in the previous Article 21.5 review – has admitted that commercial rates may be below CIRR and therefore not confer a benefit within the meaning of Article 1.<sup>14</sup>

12. Canada is not alone in this opinion. The current (7 March 2001) web page for Eksportfinans, the Norwegian Export Credit Agency, offers 8.5 year or longer United States dollar financing at the CIRR, which it lists as 6.13 percent. It also offers a "fixed market" rate for 7.0 years or longer of 5.8 percent.<sup>15</sup> Thus, for 10 year support, the Norwegian export credit agency offers a market rate that is 33 basis points below the CIRR. As noted above, PROEX III, by its terms, is limited to loans up to a maximum of 85 percent of the cost of the aircraft, for a period of 10 years at the CIRR or above the CIRR. Since these terms conform fully with what is offered in the market, PROEX III, on its face, cannot be found to confer a benefit.

13. There is additional evidence in support of this conclusion. David Stafford, former Chairman of the OECD Participants' Nuclear Sector and Aircraft Sector Groups, observes: "The CIRR system ... does provide a reasonable compromise in trying to formulate a proxy market rate ... My experience suggests that the CIRRs are about right or, if anything, marginally high."<sup>16</sup> In addition, Mr. Fumio Hoshi, Director-General of the International Finance Policy Department of the Japan Bank for International Cooperation, noted in his presentation at the EXIMBANK 65<sup>th</sup>

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<sup>9</sup> The original Portuguese version and the official English translation of Circular Letter No. 002881 are attached as Exhibit Bra-2.

<sup>10</sup> The original Portuguese version and the official English translation of Directive 374 are attached as Exhibit Bra-3.

<sup>11</sup> *Id.*, Annex, NCM Heading 8802 (attached as Exhibit Bra-3).

<sup>12</sup> Canada – Measures Affecting the Export of Civilian Aircraft, AB-1999-2, WT/DS70/AB/R (2 August 1999), para. 157.

<sup>13</sup> *Brazil – Export Financing Programme for Aircraft*, AB-1999-1, WT/DS46/AB/R (2 August 1999), para. 182.

<sup>14</sup> Original 21.5 Report, para. 6.99.

<sup>15</sup> <<http://222.eksportfinans.no/eprise/main/EF/content/english/Inngangs>> (visited 7 March 2001) (copy attached as Exhibit Bra-4).

<sup>16</sup> David Stafford, *Wallen, Helsinki, Schaerer et al.: Some Major Achievements, Some Challenges to Meet*, in THE EXPORT CREDIT ARRANGEMENT, ACHIEVEMENTS AND CHALLENGES 1978-1998 (OECD, 1998). The text of the article is attached as Exhibit Bra-5.

Anniversary Conference in May 2000 that the CIRR may actually be "excessively high."<sup>17</sup> Thus, the CIRR reflects with reasonable precision the market rate or, according to some, is in fact higher than the market rate. Either way, interest rate support at or above the CIRR does not confer a benefit.

14. Brazil notes that by conforming PROEX III to comply with the CIRR, Brazil appears to have complied with Canada's claimed objective in these proceedings of requiring Brazil to conform to the CIRR. Indeed, in its Second Oral Submission to the original Panel, Canada stated unequivocally that it "would not have brought this case" if only "PROEX simply reduced the interest rate offered to an airline to one that is above LIBOR or OECD rates."<sup>18</sup> Despite achieving its original stated goal, Canada has once again raised the bar, now seeking to impose on Brazil standards that, on their face, are more onerous than both those specified in the SCM Agreement and, more importantly, those used in practice by developed countries such as Canada itself.

15. Finally, as shown below, PROEX III complies with the interest rates provisions of the *OECD Arrangement*. Because PROEX III provides interest rate support in conformity with the *Arrangement*, it does not confer a benefit. In addition, Article 8, para. 2 of Resolution 002799 requires the Committee on Export Credits that co-administers PROEX III (the "Committee") to use "as reference the financing terms practiced in the international market." Thus, when the Committee does so, it will be required to make sure that no benefit is conferred.

#### V. PROEX MEETS THE REQUIREMENTS OF THE "SAFE HAVEN" OF ITEM (K) SECOND PARAGRAPH

16. Brazil has shown that PROEX III, by its terms, does not confer a benefit and, therefore, is not a subsidy. Assuming *arguendo*, however, that PROEX III does confer a benefit and, therefore, is a subsidy, it nevertheless qualifies for the "safe haven" of item (k) second paragraph.

17. The second paragraph of item (k) provides:

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

18. The *OECD Arrangement* is the only "international undertaking on official export credits" under the second paragraph of item (k).<sup>19</sup> Brazil, like most Members of the WTO, is not a party to the *Arrangement* and has no voice in establishing its provisions. That is a privilege that is available only to the 23 Participants in the *Arrangement*. Accordingly, Brazil is covered by the second clause of the second paragraph because, "in practice," Brazil – through PROEX III – "applies" the interest rates provisions of the 1992 version of the *Arrangement* – the version that was incorporated by reference into the SCM Agreement on 1 January 1995.

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<sup>17</sup> Presentation by Mr. Fumio Hoshi, Director-General, International Finance Policy Department, Japan Bank for International Cooperation, at the EXIMBANK 65<sup>th</sup> Anniversary Conference, May 2000. The text of the presentation is attached as Exhibit Bra-6.

<sup>18</sup> *Brazil – Export Financing Programme for Aircraft*, Canada's Second Oral Submission to the Panel, at para. 109.

<sup>19</sup> *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, ("Canada -- Aircraft 21.5 Report"), WT/DS70/RW (9 May 2000), para. 5.78.

A. THE PANEL SHOULD MEASURE PROEX III AGAINST THE VERSION OF THE *OECD ARRANGEMENT* THAT WAS IN EFFECT ON THE DATE OF ENTRY INTO FORCE OF THE SCM AGREEMENT

19. An interpretation of the text of the second paragraph of item (k), under the *Vienna Convention on the Law of Treaties* (the "Vienna Convention"), leaves no doubt that the last version of the *OECD Arrangement* which became effective prior to the entry into force of the SCM Agreement is "the relevant undertaking" for the purposes of the second paragraph of item (k). This is the 1992 version of the *Arrangement*.

20. Article 31 of the Vienna Convention requires that a treaty be "interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." The first step therefore is to interpret the second paragraph of item (k) in accordance with the ordinary meaning of its terms.

**1. The text of item (k) second paragraph establishes that the 1992 version of the *Arrangement* applies.**

21. The text of item (k) second paragraph refers not only to the *OECD Arrangement* as it existed in 1979, but also to a "successor undertaking which *has been* adopted" by the original Members (emphasis supplied). The phrase "has been" is central to the interpretation of item (k) second paragraph. In its ordinary meaning, the present perfect tense – "has been" – refers to a "time regarded as present" when the text became effective on 1 January 1995.<sup>20</sup> It is a reference to a successor undertaking *already in existence* – an undertaking that "has been adopted."

22. The alternative interpretation – that any and every later "successor undertaking" prevails, even if adopted after the entry into force of the SCM Agreement – is not in accordance with the ordinary meaning of the text. If the text envisaged that all future versions of the *OECD Arrangement* adopted *after* the entry into force of the SCM Agreement would also be "relevant undertakings," it would have used the future tense. It would have referred to a successor undertaking which "will be adopted" or "which *may* be adopted." That the text uses the present perfect "has," and not the future "will" or the conditional "may," makes clear that the negotiators were referring only to a version of the *Arrangement* in existence at that time.

23. The only "successor undertaking" that "has been adopted" by the original Members in "a time regarded as present" when the SCM Agreement became effective is the 1992 version of the *Arrangement*. Any versions adopted after the entry into force of the SCM Agreement are not undertakings that have been adopted by the original Members at the time the SCM Agreement became effective.

**2. The context of item (k) second paragraph establishes that the 1992 version of the *Arrangement* applies.**

24. If amendments made to the *Arrangement* subsequent to 1 January 1995 were incorporated by reference into item (k) second paragraph, the effective result would be amendment of the SCM Agreement itself – an amendment made by the 23 or so participants in the *Arrangement* (out of 30 OECD member countries), not by the approximately 141 Members of the WTO. The context of item (k) second paragraph makes clear that *sub rosa* amendment of a WTO agreement was not intended.

25. Article 31.2 of the Vienna Convention provides that the context for the purpose of the interpretation of a treaty comprises "any agreement relating to the treaty" made between the parties

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<sup>20</sup> The New Shorter Oxford English Dictionary 2158 (1993).

"in connexion with the conclusion of the treaty." It can hardly be disputed that all WTO agreements – including the Marrakesh Agreement itself, and the DSU – provide the context for the proper interpretation of the SCM Agreement.

26. The process of amendment is extremely important in the WTO Agreement, as it is in any treaty. The terms of a treaty are carefully negotiated, and are not changed lightly or casually. Article X of the Marrakesh Agreement reflects the importance of amendments to the WTO by providing a detailed and precise system for their adoption, a system designed to protect the interests of all Members.

27. Article X:1 of the Marrakesh Agreement specifies that a decision even to submit a proposed amendment to the Members shall itself be taken by consensus of the entire WTO membership. If consensus is not reached within a specified period, the decision whether to submit a proposed amendment shall be taken by a two-thirds majority of the Members. If the two-thirds majority decides to submit the amendment to the Members, paragraph 3 provides that, in most circumstances, if two-thirds accept, the amendment shall take effect only as to those that have accepted it.

28. Article X:3 of the Marrakesh Agreement further requires that any amendments to an Agreement in Annex IA (which includes the SCM Agreement) "that would alter the rights and obligations of the Members" take effect only "for the Members that have accepted them." The only exception is provided with respect to amendments that "would not alter the rights and obligations of the Members." Those amendments, under Article X:4, "take effect for all Members upon acceptance by two thirds of the Members."

29. An interpretation of item (k) that envisages the possibility of a handful of OECD countries amending the scope of the exception for the entire WTO membership, *after* the entry into force of the SCM Agreement, would evade the amendment process entirely, and could lead to significant alteration of the rights and obligations of the Members of the WTO in regard to export credits.

30. Further, Article 3.2 of the DSU provides that, "Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements." This provision is intended, *inter alia*, to further the predictability of the multilateral trading system, to which the dispute settlement system is a central element. It cannot be disputed that, through amendment to the *Arrangement*, its participants could "diminish the rights and obligations provided in the covered agreements" with regard to export credits, if subsequent versions of the *Arrangement* were incorporated by reference into item (k) second paragraph. This further confirms that the text of item (k) refers to the version of the *Arrangement* in effect on 1 January 1995, and to no later version or versions.

31. In addition, Article 31.3© of the Vienna Convention requires that "any relevant rules of international law" be taken into account together with the context. The law of treaties does not rule out that governments may agree, pursuant to the provisions of an existing treaty, to be bound by the provisions of a future treaty. However, such an agreement must be explicit and unambiguous; under Article 30(2) of the Vienna Convention, the existing treaty must "specify that it is subject to" a later treaty. The second paragraph of item (k) does not meet that requirement; its text makes it clear that it is subject to only an undertaking that "*has been adopted*," *i.e.*, an existing undertaking, not a future one.

32. Finally, a determination that the OECD may amend a crucial provision of the SCM Agreement at will, regardless of the views of the remainder of the WTO membership, would have serious constitutional implications for Members – like Brazil – that incorporate the WTO Agreements into their domestic law. No nation would confer *carte blanche* on non-citizens or other governments to effect changes in its domestic law. The second paragraph of item (k) should not be interpreted to say that Members of the WTO have done so.

**3. The object and purpose of item (k) second paragraph establishes that the 1992 version of the *Arrangement* applies.**

33. The final stage of the analysis under Article 31 of the Vienna Convention requires an interpretation of the terms of a treaty in light of its object and purpose. The object and purpose of the SCM Agreement include establishing disciplines for the conduct of Members in providing subsidies to their industries that would be clear, transparent, fair, binding on all Members, and enforceable.

34. It is one thing to say that, when the WTO Members negotiated and gave effect to the SCM Agreement, they knew the terms of the most recent version of the *OECD Arrangement*, and were willing to incorporate by reference its interest rates provisions into item (k). It is quite another thing to say that they intended to give the OECD *carte blanche* to amend the SCM Agreement, and to add to or diminish the rights and obligations provided by that Agreement.

35. The Panel in *Canada – Aircraft* explicitly ruled that the second paragraph of item (k) should "not be interpreted in a manner that allows that subgroup of Members [the OECD Members] to create for itself *de facto* more favourable treatment under the SCM Agreement than is available to all other WTO Members. The *OECD Arrangement*, as a plurilateral arrangement to which most WTO Members are not Participants, clearly has the *potential* to give rise to the discretion of individual Members or group of Members."<sup>21</sup>

36. This statement is extremely important. For example, nothing Brazil or the WTO might say or do could prevent the OECD from amending the *Arrangement's* provisions regarding regional aircraft in a manner that specifically disadvantaged Brazil and Embraer. They could, for example, specify that interest rate support may not be used for exports of regional aircraft. An interpretation of item (k) that allowed even for the possibility of a WTO agreement's being amended in such a fashion should be avoided unless absolutely compelled. Nothing in item (k) permits, let alone compels, such an interpretation.

**4. A different interpretation of the second paragraph of item (k) leads to a result that is manifestly absurd and unreasonable.**

37. Article 32(b) of the Vienna Convention provides that an interpretation that "leads to a result which is manifestly absurd or unreasonable" should be avoided. It would be unreasonable to interpret the text of the second paragraph of item (k) to mean that 141 WTO Members have agreed to allow 23 OECD countries to amend the scope of the "safe haven" at their will. It would be absurd to interpret an agreement subject to strict and detailed amendment requirements as permitting a small group of outsiders to amend a vital part of its provisions, thereby adding to or diminishing the rights and obligations of its Members. It would be manifestly unreasonable and absurd to interpret the text to mean that those WTO Members that incorporate the Agreements into their domestic law have given the *OECD Arrangement* Participants authority to amend that law.

38. If the OECD had the right to amend the SCM Agreement through the *Arrangement*, the consequences truly would be bizarre. The 23 Participants in the *Arrangement* would be authorized to impose binding obligations on some 141 WTO Members by means of adopting instruments that are not even binding within the OECD itself. The *Arrangement*, it will be recalled, is simply a "Gentlemen's Agreement," with no enforcement provisions.

39. Moreover, the Participants in the *Arrangement* would be authorized to include in the scope of the "safe haven" export credit practices they engage in while excluding export credit practices of other WTO Members who are not members of the OECD. Simply stating these possibilities demonstrates conclusively that an interpretation that post-1995 versions of the *Arrangement* are relevant to item (k)

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<sup>21</sup> *Canada – Aircraft* 21.5 Report, para. 5.132.

second paragraph is an interpretation that leads, in the words of Article 32(b) of the Vienna Convention, "to a result which is manifestly absurd and unreasonable."

40. Accordingly, for all these reasons, Brazil submits that the Panel must examine the issue of whether PROEX III is in conformity with the interest rate provisions of an international undertaking on official export credits by reference to the text of the 1992 version of the *OECD Arrangement*, not any later version.

**B. PROEX III IS IN FULL CONFORMITY WITH THE RELEVANT INTEREST RATE PROVISIONS OF THE 1992 *OECD ARRANGEMENT***

41. The second paragraph of item (k) makes reference only to the "interest rates provisions" of the *Arrangement*, not to the provisions governing the terms and conditions of export credits, which are broader. The interest rates provisions of the 1992 *Arrangement* are those set out in Article 5 of the main text and Article 21 of Annex IV: Sectoral Understanding on Export Credits for Civil Aircraft.<sup>22</sup> PROEX III conforms with these provisions of the *Arrangement*. Brazil does not agree with the approach of the Panel in *Canada – Aircraft*, which used a broad approach to identify what it believed were the interest rates provisions of the 1998 *OECD Arrangement*.<sup>23</sup> However, even if the same broad approach is applied to the 1992 *OECD Arrangement*, Brazil conforms with the corresponding interest rates provisions: Articles 3 through 7 of the main text, and Articles 17 through 22 and Articles 24 and 25 of Annex IV. Brazil, under PROEX III, applies in practice those provisions of the 1992 *OECD Arrangement* as required by the second paragraph of item (k).

42. PROEX III conforms with the 1992 *OECD Arrangement* because all PROEX III supported transactions in the regional aircraft sector take the form of official financing support with a repayment term of two years or more, as required by Article 1 of the *Arrangement*.

43. PROEX III complies with Article 3 of the *Arrangement*, which requires that purchasers make cash payments equal to a minimum of 15 percent of the export contract value; the maximum percentage allowed under PROEX III for the purpose of interest rate equalization is 85 percent of the export value of the sale.<sup>24</sup>

44. Article 4 of the *Arrangement* relates to the terms of repayment. However, pursuant to Articles 1(b) and 9(d) of the *Arrangement*, these provisions are superseded by Article 21 of Annex IV dealing specifically with the aircraft manufactured by Embraer. PROEX III is in conformity with the provisions of that Article, as discussed below.

45. Article 5(a) of the *Arrangement* fixes the minimum interest rate at the relevant CIRR. The official financing support to the regional aircraft industry under PROEX III is at fixed interest rates only.<sup>25</sup> The net interest rates of all transactions in the regional aircraft sector under PROEX III are at or above the relevant CIRR.<sup>26</sup>

46. Articles 6 (Local Costs) and 7 (Maximum Period of Validity of Commitments, Prior Commitments and Certain Aid Commitments) are not relevant to PROEX III because no aircraft credits are granted, financed, refinanced, guaranteed or insured under PROEX III. Article 1 of Resolution 002799 explicitly states that PROEX III provides only interest rate support "enough to render financing costs compatible with those practiced in the international market" and that the financing to the regional aircraft industry is in the form of interest rate support in compliance with the

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<sup>22</sup> The text of the 1992 *OECD Arrangement* is attached as Exhibit Bra-7.

<sup>23</sup> *Canada -- Aircraft* 21.5 Report, para. 5.147(d).

<sup>24</sup> Article 5 of Directive No. 374.

<sup>25</sup> Article 1, para. 2 of Resolution No. 002799.

<sup>26</sup> Article 1, para. 1 of Resolution No. 002799. As will be discussed below, the SDR-based rates referred to in Article 5(b) of the *Arrangement* are no longer relevant.

CIRR.<sup>27</sup> Moreover, Article 5 of Directive 374 explicitly limits the interest rate support to 85 percent of the export value of the contracted sale, thus clearly excluding additional local costs.

47. Articles 17 through 20 of Annex IV to the *Arrangement* describe the scope of Chapter II of Annex IV relating specifically to aircraft other than large commercial aircraft. PROEX III falls within that scope and is therefore covered by the interest rates provisions of that Chapter.

48. Article 21 of Annex IV requires that the maximum length of the financing term is 10 years at the respective CIRR. The maximum length of the financing term under PROEX III is 10 years.<sup>28</sup>

49. Article 21 of Annex IV of the 1992 *OECD Arrangement* provides an alternative benchmark for the maximum term of financing: "ten years at SDR-based rate for recipient countries classified in category III." This alternative benchmark, however, was removed from the *Arrangement* in 1994 when the OECD adopted a set of guidelines, referred to as the "Schaerer Package." This abolished the SDR-based interest rates "so that the CIRR system, intended to reflect market rates more closely, would apply for all countries."<sup>29</sup> At any event, the SDR-based system is not relevant in the context of PROEX III because PROEX III is in compliance with the specified term of 10 years at the relevant CIRR.

50. Articles 22 (Sales or Leases to Third Countries (relay countries)), 24 (Insurance Premiums and Guarantee Fees) and 25 (Tied Aid Credit Prohibitions) are not relevant to PROEX III because PROEX III does not provide for such practices.

51. For these reasons, PROEX III, measured against the relevant provisions of the 1992 *OECD Arrangement*, qualifies for the "safe haven" of the second paragraph of item(k).

#### C. PROEX III IS IN FULL CONFORMITY WITH THE RELEVANT INTEREST RATE PROVISIONS OF THE 1998 *OECD ARRANGEMENT*

52. While Brazil will, through PROEX III, in practice apply the interest rates provisions of the version of the *Arrangement* that was incorporated by reference into item (k) second paragraph, it is clear that the same is true for the latest (1998) version of the *Arrangement* as well.<sup>30</sup> The difficulty, however, as noted above, is that the OECD could change these requirements tomorrow – without notice to Brazil, without notice to the WTO, without notice to anyone. Indeed, insofar as Brazil is aware, there has been no official notification to the WTO or any of its Members by the OECD or any of its members of the issuance of the 1998 version of the *Arrangement*. Thus, if the participants in the *Arrangement* decide to change the requirements, Brazil and any other non-OECD participant, unknowingly, would no longer be applying the interest rates provisions of the *Arrangement*.

53. In the view of Brazil, the relevant interest rates provisions of the 1998 *OECD Arrangement* are Articles 15 through 19 of the main text and Article 22 of Annex III. PROEX III conforms to all these provisions.

54. The Panel in *Canada – Aircraft* identified Articles 7 through 10 and 12 through 26 of the main text and Articles 18 through 24 and Articles 27 through 29(a)-(c) of Annex III as the applicable provisions of the 1998 *OECD Arrangement*.<sup>31</sup> Brazil disagrees with this finding of the Panel, and believes that the relevant interest rates provisions are limited to Articles 15 through 19, as noted above. However, even assuming that the conclusion of the Panel in *Canada – Aircraft* was correct,

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<sup>27</sup> Article 1 of Resolution No. 002799.

<sup>28</sup> Circular-Letter No. 002881 and Annex to Directive No. 374.

<sup>29</sup> A summary of the Schaerer Package provided in THE EXPORT CREDIT ARRANGEMENT, ACHIEVEMENTS AND CHALLENGES, 1978-1998 (OECD, 1998), at p. 20, is attached as Exhibit Bra-8.

<sup>30</sup> The text of the 1998 *OECD Arrangement* is attached as Exhibit Bra-9.

<sup>31</sup> *Canada – Aircraft* 21.5 Report, para. 5.147.

PROEX III conforms to all of these provisions, including both the minimum interest rates and "all other applicable" provisions of the 1998 *OECD Arrangement* that "operate to support or reinforce the minimum interest rate"<sup>32</sup> with one arguable exception.

55. PROEX III transactions are official financing support with a repayment term of two years or more, as required by Article 2 of the 1998 *Arrangement*. In fact, PROEX III complies fully with the requirements of Annex III, Article 21, which provides that the maximum repayment term for Category A aircraft (which includes Embraer's jets), is 10 years.<sup>33</sup> PROEX III support is also limited to fixed interest rate transactions.<sup>34</sup>

56. PROEX III complies with the requirements of the 1998 *Arrangement* regarding minimum interest rates. The 1998 *Arrangement* provides in Annex III, Article 22, "the Participants providing official financing support shall apply minimum interest rates; the Participants shall apply the relevant CIRR set out in Article 15 of the *Arrangement*." Article 15 in turn provides that the Participants providing official financing support through direct credits/financing, refinancing, or interest rate support shall apply the CIRR rates and lays out the relevant principles to be used in calculating the CIRRs. By requiring compliance with the CIRR, Resolution 002799 clearly conforms with the basic requirements of the 1998 *OECD Arrangement*.

57. PROEX III also complies with the other relevant provisions of the 1998 *Arrangement*. PROEX III interest rate support is limited to 85 percent financing of the value of the sale. Again, this conforms with Article 7 of the 1998 *Arrangement* (as well as Annex III, Article 6.a., though this applies only to large aircraft and not Category A aircraft). In addition, as explained above, PROEX III provides interest rate support at fixed interest rates for a maximum repayment term of 10 years.

58. As is the case with the 1992 *Arrangement*, some of the interest rates provisions of the 1998 *Arrangement* are not relevant to PROEX III because PROEX III does not provide for granting, financing, refinancing, guaranteeing or insuring credits to the regional aircraft industry. As explicitly stated in Article 1 of Resolution 002799, PROEX III provides only interest rate support "enough to render financing costs compatible with those practiced in the international market."<sup>35</sup>

59. The only possible exception is the provision of Article 29(a) of the Annex dealing with spare parts. That provision was in the section dealing with large aircraft in the 1992 *Arrangement*. It was moved to a separate section to cover both large and "other" aircraft in 1998. Thus, in 1996, when this case began, Brazil was in compliance with this particular provision. Without notice to the WTO and without notice to Brazil, the requirement was expanded in 1998 – *two years after this dispute began* – to cover "other" aircraft as well. This is a perfect illustration of the point that interpreting the second paragraph of item (k) to allow the OECD to amend the requirements of the "safe haven" leads to a result that is manifestly absurd, unreasonable and unfair.

60. Article 29(a) limits financing for spare parts to a maximum of 15 percent of the aircraft price for the first five aircraft and to 10 percent for the sixth and subsequent aircraft. Article 6 of Directive 374 provides that "Parts and spares may be included in a transaction, in a consolidated form up to a limit of twenty percent (20%) of the aggregate value of the other goods." In the view of Brazil, however, this provision of PROEX III conforms to the requirements of the interest rates provisions of the 1998 *OECD Arrangement*.

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<sup>32</sup> *Id.*, para. 5.114.

<sup>33</sup> Article 3(c) of the *Arrangement* provides that provisions of the Sector Understanding shall prevail over corresponding provisions of the *Arrangement*; Article 21 of Annex III supercedes Article 7 of the main text of the *Arrangement*.

<sup>34</sup> Article 1, para. 2 of Resolution No. 00279.

<sup>35</sup> Article 1 of Resolution No. 00279.

61. First, Brazil disagrees with the *Canada – Aircraft* Panel and believes that Article 29 is not an interest rate provision. The interest rates provisions of the 1998 *Arrangement* are Articles 15 through 19 of the main text and Article 22 of the Annex. PROEX III fully conforms with those provisions. While Article 6 of Directive 374 gives the Committee the discretion to finance up to 20% of the spare parts included in a transaction, the Committee is not required to do so and will not do so with respect to regional aircraft because of the insignificant percentage of the value of the spare parts included in regional aircraft export sales.<sup>36</sup> This is a discretionary, not a mandatory, provision. Brazil, therefore, in practice applies the interest rates provisions of the 1998 *Arrangement*.

62. For all these reasons PROEX III conforms with all the provisions of the 1998 *Arrangement* and its relevant Sector Understanding that the *Canada – Aircraft* Panel described as reinforcing the minimum interest rate for Brazil's regional jet transactions and hence as the "interest rate provisions" of that *Arrangement*. The Panel should therefore find that PROEX III qualifies for the "safe haven" of the second paragraph of item (k).

## **VI. PROEX III IS NOT USED TO CONFER A MATERIAL ADVANTAGE WITHIN THE MEANING OF ITEM (K) FIRST PARAGRAPH**

63. Brazil has demonstrated that PROEX does not confer a benefit within the meaning of Article 1 of the SCM Agreement, and therefore is not a subsidy. Brazil also has demonstrated that – assuming *arguendo* that PROEX is a subsidy – it qualifies for the safe haven of item (k) second paragraph. In addition, however, it is Brazil's contention that PROEX III is not used to secure a material advantage in the field of export credit terms within the meaning of item (k) first paragraph. In this portion of this submission, Brazil will demonstrate why this is the case.

### **A. PROEX DOES NOT PROVIDE A MATERIAL ADVANTAGE**

64. Even if the Panel determines that PROEX III does not qualify for the safe haven of the second paragraph of item (k), Brazil submits that PROEX III equalization support is not a prohibited export subsidy, because PROEX III payments do not confer a material advantage in the field of export credit terms within the meaning of the first paragraph of item (k).

65. As noted above, in the first Article 21.5 proceedings in this matter, the Appellate Body found that Brazil had failed to show that PROEX II was not used to secure a material advantage in the field of export credit terms. The Appellate Body stated that to establish that PROEX payments are not used to secure a material advantage, Brazil must prove *either* that the net interest rates under the revised PROEX are at or above the relevant CIRR, the specific 'market benchmark' identified in the original dispute as an 'appropriate' basis for comparison; *or*, that an alternative 'market benchmark is appropriate.'<sup>37</sup> PROEX III stipulates that the net interest rates must be at or above the relevant CIRR. Thus, PROEX III complies fully with the CIRR, a benchmark determined by the Appellate Body not to confer a material advantage. In addition, Article 8, para. 2 of Resolution 002799 requires the Committee to use "as reference the financing terms practiced in the international market." Thus, when the Committee does so, it will be required to make sure that no material advantage is provided.

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<sup>36</sup> The value of spare parts in Embraer's regional aircraft sales transactions is *de minimis*. The arbitrators in the 22.6 proceedings in *Brazil – Aircraft* concluded that "there is no financing for spare parts under PROEX for the ERJ-135" and that the "approximate average figure" for spare parts per ERJ-145 is \$20,000. Thus, on average, according to the arbitrators, the value of spare parts does not exceed 0.5% of the price of the aircraft. *Brazil – Export Financing Programme for Aircraft*, Decision of the Arbitrators, WT/DS46/ARB (28 August 2000), paras. 3.68-3.72. *De minimus non curat lex*.

<sup>37</sup> Appellate Body 21.5 Report, para. 67.

B. AN A *CONTRARIO* INTERPRETATION OF ITEM (K) FIRST PARAGRAPH IS REQUIRED

66. Brazil submits that the material advantage clause should be interpreted *a contrario* such that a payment that is *not* used to secure a material advantage within the meaning of the first paragraph is *not prohibited*, and is therefore *permitted*, under the SCM Agreement. The failure to permit an *a contrario* interpretation effectively would render the material advantage clause inutile, contrary to the customary rules of interpretation of public international law.

67. In reviewing this issue in the original Article 21.5 proceedings, the Appellate Body began its analysis by considering whether PROEX II in fact conferred a material advantage.<sup>38</sup> As noted above, the Appellate Body concluded that Brazil had not discharged its burden of showing that PROEX III did not confer a material advantage. Regarding Brazil's *a contrario* argument, however, the Appellate Body went on to say that if Brazil had discharged this burden, the Appellate Body "*would have been prepared to find*" that an *a contrario* interpretation of the material advantage clause could be used to justify PROEX payments.<sup>39</sup> Thus, as a legal matter, the Appellate Body appears to take the view that assuming the other legal conditions are met, the first paragraph of item (k) should be read *a contrario* to permit a subsidy that does not confer a material advantage. This Panel should reach the same conclusion.

## C. PROEX IS A "PAYMENT" WITHIN THE MEANING OF ITEM (K) FIRST PARAGRAPH

68. PROEX III interest rate support is a "payment by [Brazil] of all or part of the costs incurred by exporters or financial institutions in obtaining credits" within the meaning of item (k) first paragraph.

69. Neither exporters nor financial institutions wish to obtain credits in order to hoard them; they wish to "obtain" credits only to "provide" them. Before credits can be provided, they must be obtained – obtained at a cost, and, in the case of a developing country like Brazil, a considerable cost.

70. When the lending institution is outside of the country, Embraer, the Brazilian exporter, faces costs in obtaining for its customer a financial package that is competitive in the market, including a market in which "market window" operators, such as Canada, are offering rates below the CIRR. If Embraer could not obtain a competitive financial package for its customer, it would be forced to take other costly action, such as paying for a commercially-available loan guarantee at a high premium. When the lender is inside the country, however, it is the lender itself – the bank in Brazil – that must obtain dollars in the market in order to provide dollar credits. This analysis was effectively confirmed by the original Article 21.5 Panel, which observed that "developing countries' costs of borrowing are almost inevitably higher than those of developed counties."<sup>40</sup>

71. PROEX interest rate support payments are payments designed to offset, at least partially, the added costs faced by Brazilian institutions in obtaining the credits they provide.

72. If PROEX payments do not fit the definition of "payments" contemplated by item (k), it is impossible to contemplate exactly what kind of payments in the export credit field the drafters of this provision had in mind. The original Article 21.5 Panel stated that "a payment by Brazil that allowed a Brazilian financial institution to provide export credits" could be permitted under the first paragraph of item (k).<sup>41</sup> This Panel should follow the logic of that statement and find that PROEX III payments are "payments" within the meaning of the first paragraph of item (k).

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<sup>38</sup> *Id.*, para. 58.

<sup>39</sup> *Id.*, para. 80.

<sup>40</sup> Original 21.5 Report, para. 6.73.

<sup>41</sup> Original 21.5 Report, para. 6.44.

## VII. CONCLUSION

73. Brazil does not understand Canada's purpose in again seeking recourse to Article 21.5, especially without first seeking consultations with Brazil on its concerns regarding PROEX III. As noted above, Canada has previously described its purpose in these proceedings as seeking to ensure that Brazil would provide PROEX support only at or above the CIRR. As the Panel is aware, Brazil is of the view that – as, indeed, Canada has admitted – transactions in the regional jet market occur below the CIRR, and that Brazil should therefore not have to comply with standards that are honoured more in breach than in observance by the group of developed country Members who themselves developed those standards. Nevertheless, in response to the rulings and recommendations of the DSB, Brazil has complied with Canada's stated wishes and conformed PROEX to the interest rate provisions of the *Arrangement*, as required by the second paragraph of item (k) of the SCM Agreement. The sole issue before this Panel is whether the regulations governing PROEX conform to the relevant provisions of the *Arrangement*. The Panel should answer this question in the affirmative and not yield to Canada's efforts once more to move the goalposts for Brazil.

74. Accordingly, Brazil requests that the Panel find and determine that Canada has not established that PROEX III confers a benefit within the meaning of Article 1 of the SCM Agreement and, accordingly, that Canada has not sustained its burden of proving that PROEX III is a subsidy.

75. However, even if the Panel should find that PROEX is a subsidy within the meaning of Article 1, contingent upon export within the meaning of Article 3, PROEX is nevertheless not prohibited because:

- (a) Brazil in practice applies the interest rates provisions of the relevant undertaking – the 1992 version of the *Arrangement on Guidelines for Officially Supported Export Credits* of the OECD;
- (b) Brazil in practice applies the interest rates provisions of the 1998 version of the *Arrangement on Guidelines for Officially Supported Export Credits* of the OECD;
- (c) PROEX interest rate support is not used to provide a material advantage in the field of export credit terms.

### LIST OF EXHIBITS

- BRA-1. Resolution No. 002799 of the Central Bank of Brazil, 6 December 2000 (Portuguese and English versions)
- BRA-2. Circular letter No. 002881 of the Central Bank of Brazil, 19 November 1999 (Portuguese and English versions)
- BRA-3. Directive No. 374 of the Ministry of Development, Industry and Foreign Trade, 21 December 1999, and selected pages of the Annex thereto (Portuguese and English versions)
- BRA-4. Printout of <http://222.eksportfinans.no/eprise/main/EF/content/english/Inngangs>
- BRA-5. David Stafford, *Wallen, Helsinki, Schaerer et al.: Some Major Achievements, Some Challenges to Meet*, in THE EXPORT CREDIT ARRANGEMENT, ACHIEVEMENTS AND CHALLENGES 1978-1998 (OECD, 1998)
- BRA-6. Presentation by Mr. Fumio Hoshi, Director-General, International Finance Policy Department, Japan Bank for International Cooperation, at the EXIMBANK 65<sup>th</sup> Anniversary Conference, May 2000
- BRA-7. 1992 *OECD Arrangement* on Guidelines for Officially Supported Export Credits
- BRA-8. Summary of The Schaerer Package, in THE EXPORT CREDIT ARRANGEMENT, ACHIEVEMENTS AND CHALLENGES 1978-1998 (OECD, 1998)
- BRA-9. 1998 *OECD Arrangement* on Guidelines for Officially Supported Export Credits

**ANNEX B-2**

**SECOND SUBMISSION OF BRAZIL**

(23 March 2001)

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## I. INTRODUCTION

1. In its First Submission of 2 March 2001, Canada asserts that Brazil's *Programa de Financiamento às Exportações* ("PROEX III") is a prohibited export subsidy within the meaning of Articles 1 and 3 of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement" or "Agreement"). Next, Canada examines PROEX III in light of the first paragraph of item (k) of Annex I to the SCM Agreement, and concludes that PROEX III does not qualify for any exemption that paragraph may offer. Canada does not address the second paragraph of item (k) which provides that, when Members "in practice" "apply" the interest rates provisions of the *Arrangement on Guidelines for Officially Supported Export Credits* of the Organization for Economic Cooperation and Development ("*OECD Arrangement*" or "*Arrangement*"), they are not providing prohibited subsidies.

2. The practical consequence of Canada's position is that high-technology industries like aircraft are the exclusive preserve of the developed countries; developing countries should stick to light manufactures and commodities. This is because, historically, the developed countries have supported industries, such as aircraft, with export credits that provide better terms than those available on the market. The result is that trade in aircraft depends not only on the price and quality of the product, but also on which government grants the more favourable financing terms. Because developed country governments enjoy better credit ratings and a lower cost of funds than do developing country governments, they are able to provide their exporters with more favorable export credits than are developing countries – credits that can overcome product price and quality differences.

3. In previous proceedings Brazil has shown, and the first Article 21.5 Panel has found, that developing countries, such as Brazil, simply are not able to compete with the credit ratings of developed countries in offering loan guarantees, and are not able to compete with the treasuries of developed countries in offering direct financing.<sup>1</sup> They are forced, by default, to rely largely on interest rate support in supplying export credits.<sup>2</sup>

4. Meanwhile, developed countries, such as Canada, are free not only to offer direct financing, but to do so through their so-called "market window" operations. The Head of the OECD Trade Directorate and a specialist in the OECD Export Credit Division have characterized these "so-called 'market window' operations" as "institutions related to governments which are able to raise finance and lend at very low rates but which may not currently follow all the provisions of the Arrangement."<sup>3</sup>

5. Using the "very low rates" that do not "follow all of the provisions of the Arrangement," Canada, and some other developed countries, may make financing available at rates that are below the Commercial Interest Reference Rate ("CIRR") of the *Arrangement*. But, the argument continues, these rates are "commercial."<sup>4</sup> Further, developed countries may make financing available for periods that exceed the limits of the *Arrangement*, but these, too, are called "commercial."<sup>5</sup> In Canada's view, there appears to be one set of rules for one group of Members, and another, more stringent set of rules for another group of Members. For the reasons explained below, this view is wrong, as a matter of law as well as policy.

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<sup>1</sup> Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU, WT/DS46/RW (9 May 2000) ("Original 21.5 Report"), para. 6.58-59.

<sup>2</sup> *Id.*, para. 659.

<sup>3</sup> Steve Cutts and Janet West, "The Arrangement on Export Credits," *The OECD Observer* No. 211, April/May 1998 at 12, 14 (Exhibit Bra-10).

<sup>4</sup> Original 21.5 Report, para. 6.99: "We were, however, struck by Canada's assertion that export credits provided by EDC through the 'market window,' even at interest rates below CIRR, were nevertheless 'commercial' export credits that did not confer a benefit within the meaning of Article 1."

<sup>5</sup> *Id.*, at page 94 (Canada's Answer to question 8 of The Panel's Further Questions).

## II. QUESTION PRESENTED

6. The question presented to this Panel is "whether the measures taken by Brazil to comply with the rulings and recommendations of the DSB 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."<sup>6</sup>

7. During the Article 22.6 Arbitration proceedings,<sup>7</sup> Canada was authorized to suspend concessions to Brazil in the amount of C\$344.2 million per year as appropriate countermeasures within the meaning of Article 4.10 of the SCM Agreement. This authorization was based on a calculation of the amount of subsidies under PROEX I and II deemed to be prohibited in the previous Panel proceedings. Accordingly, Brazil distinguishes between the so-called "undelivered aircraft" – aircraft subject to the calculation of the level of authorized countermeasures in the Article 22.6 proceedings – and any new PROEX III commitments. Brazil has stated repeatedly that it is unable to default on commitments it made to private parties who have relied, in good faith, on Brazil's commitments for the undelivered aircraft. The sole issue before this Panel, therefore, is whether PROEX III now complies with the requirements of the SCM Agreement for new orders.

## III. BURDEN OF PROOF

8. In its submission, Canada asserts that it has presented evidence that satisfies its burden of proving that payments under PROEX III "continue to be prohibited export subsidies."<sup>8</sup> Canada has done nothing of the kind.

9. Under the standard articulated by the Appellate Body in *Chile – Alcoholic Beverages*, PROEX III enjoys a presumption of compliance:

Members of the WTO should not be assumed, in any way, to have *continued* previous protection or discrimination through the adoption of a new measure. This would come close to a presumption of bad faith.<sup>9</sup>

10. Canada's assertion that it has met this legal and evidentiary burden is incorrect. Its "proof" that PROEX III is a subsidy is based entirely on its assertion that, "as has been confirmed twice before by both the Panel and the Appellate Body, PROEX payments *continue* to involve a direct transfer of funds from the Government of Brazil that confers a benefit."<sup>10</sup> Yet as Canada itself has acknowledged, "this second Article 21.5 proceeding is to consider only whether PROEX III is consistent with the SCM Agreement."<sup>11</sup> Since neither the Panel nor the Appellate Body has previously examined PROEX III, Canada's references to the prior findings regarding PROEX I and PROEX II are irrelevant. These references to past measures do not discharge Canada's threshold burden to establish that the programme now before this Panel – PROEX III – constitutes a prohibited export subsidy. Moreover, Canada's legal arguments regarding PROEX III are insufficient to discharge this burden.

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<sup>6</sup> WT/DS46/26 (22 January 2001).

<sup>7</sup> Brazil – Export Financing Programme for Aircraft – Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.10 of the SCM Agreement, Decision by the Arbitrators, WT/DS46/ARB (28 August 2000).

<sup>8</sup> Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU, First Submission of Canada (2 March 2001) ("Canada First Submission"), para 20.

<sup>9</sup> *Chile – Taxes on Alcoholic Beverages*, WT/DS87/AB/R, WT/DS110/AB/R (13 December 1999) (Adopted 12 January 2000), para. 74 (emphasis in original).

<sup>10</sup> Canada First Submission, para. 23 (emphasis added).

<sup>11</sup> *Id.*, para. 19.

#### IV. LEGAL ARGUMENT

##### A. CANADA HAS NOT ESTABLISHED THAT PROEX III INTEREST EQUALIZATION PAYMENTS FOR AIRCRAFT CONSTITUTE A SUBSIDY

11. Canada claims that "Brazil continues to acknowledge that PROEX [III] subsidies are prohibited export subsidies."<sup>12</sup> This statement is incorrect. Brazil acknowledges no such thing. Canada's added claim, in footnote 22 to its First Submission, that Brazil has acknowledged that PROEX payments were "prohibited export subsidies" also is incorrect. Brazil has acknowledged nothing of the sort. What Brazil has argued in the past is that PROEX interest equalization payments, as they were constituted in the prior proceedings, were subsidies contingent upon export, but that they were not "prohibited" under the SCM Agreement.

12. Canada has presented no evidence that would establish that PROEX III confers a benefit in the sense that, in the words of the Appellate Body, it confers "terms more favorable than those available to the recipient in the market."<sup>13</sup> A financial contribution that does not confer a benefit is not a subsidy.<sup>14</sup> Canada's argument appears to be based solely on the premise that providing equalization at the CIRR confers a benefit or provides terms more favorable than those available to the recipient in the market.<sup>15</sup> As an attempt to discharge an evidentiary burden, this argument is wholly insufficient.

13. Moreover, it is completely contradicted by Canada's position in the previous two stages of these proceedings. Before the Original Panel, Canada stated that it would have not brought the case if PROEX simply matched OECD rates, *i.e.* the CIRR.<sup>16</sup> Before the Article 21.5 Panel, Canada admitted that it provides export financing at rates *below* the CIRR, and claimed that those rates were nevertheless "commercial."<sup>17</sup> Yet Canada now seeks to impugn PROEX III – which establishes the CIRR as a benchmark – as providing terms that are more favorable than those available in the marketplace. This allegation is inconsistent both with Canada's prior statements and with its own admitted practice. In the circumstances, Canada cannot be found to have discharged even a minimum legal and evidentiary burden of showing that PROEX III constitutes a prohibited export subsidy.

14. Canada is under a burden to establish that PROEX III, on its face, constitutes a prohibited export subsidy. Canada has provided no factual or legal evidence that satisfies this burden. The Panel therefore should deny Canada's request for relief in this proceeding.

##### B. CANADA HAS FAILED TO SHOW THAT PROEX III CONFERS A MATERIAL ADVANTAGE WITHIN THE MEANING OF ITEM (K) FIRST PARAGRAPH

15. Even though PROEX III, by its terms, specifically provides that all interest equalization shall conform to the CIRR, Canada, in its First Submission to the Panel, does not address the issue whether Brazil qualifies for the safe haven of the second paragraph of item (k). Canada's First Submission challenges PROEX III solely on the ground that Brazil cannot establish that PROEX III does not confer a material advantage within the meaning of the first paragraph of item (k). Brazil, for the

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<sup>12</sup> *Id.*, para. 24.

<sup>13</sup> Canada – Measures Affecting the Export of Civilian Aircraft, AB-1999-2, WT/DS70/AB/R (2 August 1999), para. 157.

<sup>14</sup> *Id.*

<sup>15</sup> Canada acknowledges that the ongoing PROEX I and II payments on the so-called "undelivered" aircraft that were at issue in the Article 22.6 proceedings in this matter are not at issue in this Article 21.5 proceeding. Canada First Submission, para. 18. However, Canada has not provided any evidence regarding any actual transactions under PROEX III.

<sup>16</sup> *Brazil – Export Financing Programme for Aircraft*, Canada's Second Oral Submission to the Panel, para. 109.

<sup>17</sup> Original 21.5 Report, pages 82, 89 (Responses by Canada to Questions of the Panel).

reasons explained in its First Submission, submits that PROEX III conforms with the relevant interest rate provisions of the *Arrangement* and therefore qualifies for the safe haven of the second paragraph of item (k). Brazil also believes, however, that PROEX III is not used to secure a material advantage within the meaning of item (k) first paragraph. Brazil explains why this is so in this section of its submission.

16. Brazil agrees with Canada that in order to prevail under item (k) first paragraph, Brazil must establish three elements.<sup>18</sup> First, Brazil must show that item (k) first paragraph may be interpreted *a contrario* such that a payment that is *not* used to secure a material advantage within the meaning of the first paragraph is *not prohibited*, and therefore is *permitted*, under the SCM Agreement. Second, Brazil must show that PROEX III payments fall within the definition of "payment by [a government] of all or part of the costs incurred by exporters or financial institutions in obtaining credits," within the meaning of the first paragraph of item (k). Third, Brazil must show that PROEX payments are not used to "secure a material advantage in the field of export credit terms." Canada's arguments on each of these three points are unavailing, and the Panel should find that PROEX III payments are not prohibited export subsidies.

## 2. The First Paragraph of Item (k) Must Be Given an *A Contrario* Interpretation

17. Item (k) of Annex I to the *SCM Agreement* provides, in relevant part, that certain governmental payments are prohibited export subsidies "in so far as they are used to secure a material advantage in the field of export credit terms." The addition of this "material advantage" clause where the paragraph would otherwise conclude necessarily affects the meaning of the paragraph. For the following reasons, the Panel should interpret this clause to mean that payments *not* used to secure a material advantage are *not* prohibited.

### (b) Standard Principles of Treaty Interpretation Favor Brazil's Interpretation

18. The first paragraph of item (k) should be interpreted in accordance with the provisions of Article 31 of the *Vienna Convention on the Law of Treaties* (the "Vienna Convention"), which provides that a treaty shall be interpreted in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose. Moreover, this Panel "must give meaning and effect to all the terms of the treaty."<sup>19</sup> While these principles appear straightforward, there nevertheless remains considerable dispute as to the "ordinary meaning" of the material advantage clause.

19. In Brazil's view, the issue is quite simple. The Panel must give meaning and effect to the material advantage clause. The minimum meaning and effect that can reasonably be given is that the clause qualifies the preceding language of the first paragraph. This must mean that the "payments" described in the preceding clauses are not all or entirely prohibited. Put another way, the language plainly calls for a distinction between payments that are used to secure a material advantage and those that are not. Thus, the ordinary, straightforward meaning of the material advantage clause is that payments that are used to secure a material advantage are prohibited subsidies, whereas payments that are not so used are not prohibited. Canada's submission contains no reading of the clause that would give the language its ordinary meaning and reach a different result.

### (c) The Maxim *Expressio Unius Est Exclusio Alterius* Supports Brazil's Interpretation

20. Canada describes the *a contrario* rule as another way of referring to the maxim *expressio unius est exclusio alterius*, which means, in effect, that by stating one proposition in a text, the

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<sup>18</sup> Canada First Submission, para. 27.

<sup>19</sup> Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products, WT/DS98/AB/R (12 January 2000), para. 80.

drafters necessarily excluded another proposition. Brazil agrees with Canada that the *a contrario* rule is related to the *expressio unius* maxim. However, Brazil disagrees with Canada that the maxim is unhelpful here. To the contrary, the *expressio unius* principle, as interpreted by the authorities relied upon by Canada, supports Brazil's construction of the first paragraph of item (k).

21. Put simply, the *expressio unius* maxim, in this case, means that by describing as prohibited subsidies payments "in so far as they are used to secure a material advantage," the drafters of the SCM Agreement necessarily intended that payments would *not* be prohibited export subsidies in so far as they are *not* used to secure a material advantage. The maxim is a "rule of both law and logic and applicable to the interpretation of treaties as well as municipal statutes and contracts."<sup>20</sup> In this instance, as a rule of law, the maxim corresponds with the principles of Article 31 of the Vienna Convention. The ordinary meaning of the language suggests that payments are prohibited only if they are used to secure a material advantage.

22. As a rule of logic, the maxim also supports Brazil's interpretation. Logically, had the drafters of the first paragraph intended to describe all "payments" as prohibited export subsidies, they simply would have ended the first paragraph right before the "in so far as" clause. The drafters did not so. Logically, therefore, they intended to qualify the description of payments that would be considered as prohibited subsidies so that *only* those payments described in the additional clause – those that are used to secure a material advantage – would be described as prohibited. Again logically, this means that the drafters intended that payments that did not fit that description – those that do not secure a material advantage – would not be proscribed.

23. Canada attempts to avoid this compelling logic by arguing that the maxim must be applied with caution. Canada quotes from a decision of an English court which stated that "the *exclusio* [i.e., the thing not expressly mentioned] is often the result of inadvertence or negligence, and the maxim ought not to be applied . . ."<sup>21</sup> This concern regarding the application, though no doubt valid, is not present here. It is impossible that the *exclusio* in this case was a result of inadvertence or negligence. To the contrary, the history of the first paragraph and the "material advantage" clause – the *expressio* in this case – makes clear that the clause was deliberately added to "restrict the definition of this type of export subsidy to instances where a 'material advantage' has been 'secured.'"<sup>22</sup>

24. The language that now comprises the first paragraph of item (k), *without* the material advantage clause, had its origins in rules adopted in 1958 by the Organization for European Economic Cooperation (the "OEEC"), the predecessor of the OECD, which prohibited:

(g) The grant by governments (or special institutions controlled by governments) of export credits at rates below those which they have to pay in order to obtain the funds so employed;

(h) The government bearing all or part of the costs incurred by exporters in obtaining credit.<sup>23</sup>

25. These provisions were included *verbatim* in a 1960 Report of a GATT Working Party on Subsidies as examples of export subsidies.<sup>24</sup> Subsequently, they provided the basis for the Illustrative List that eventually was included in the Tokyo Round Subsidies Code. It is significant, however, that

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<sup>20</sup> *United States v. Germany*, 7 R.I.A.A. 91, 111 (1924) (the *Life Insurance Claims* arbitration).

<sup>21</sup> *Colquhoun v. Brooks*, 21 QBD 52, 65.

<sup>22</sup> *Brazil – Export Financing Programme for Aircraft*, Report of the Appellate Body, WT/DS46/AB/R (2 August 1999), ("Appellate Body Report"), para. 20.

<sup>23</sup> John E. Ray, *Managing Official Export Credits – The Quest for a Global Regime*, Institute for International Economics (1995), at 35 (Exhibit Bra-11).

<sup>24</sup> BISD 9S/185 (Report adopted on 19 November 1960).

in their first appearance in a GATT document, and for the next 18 years, these provisions contained no material advantage clause.

26. Meanwhile, the *OECD Arrangement* was agreed upon in 1978, close to the 1979 conclusion of the Tokyo Round.<sup>25</sup> This presented a conflict. The *Arrangement* expressly permitted governmental action with regard to export credits – interest rate support, for example – that would fall within the definition of an export subsidy in the 1960 Working Party Report and Article XVI of GATT, which were the basis of the contemporaneous Tokyo Round negotiations. Gary Hufbauer, one of the Tokyo Round negotiators, in recounting this history, noted that, "many countries were unwilling to condemn as export subsidies those practices condoned in the OECD."<sup>26</sup> An exception, therefore, was inserted in the Code, and what is now the second paragraph of item (k) – the safe haven clause for practices that conform to the interest rates provisions of the *Arrangement* – was added.<sup>27</sup> Initially, this was all the Tokyo Round negotiators did. They did not add a material advantage clause.

27. On 10 July 1978, an *Outline of an Arrangement*, prepared by the delegations of Canada, the European Communities, Japan, the Nordic countries, and the United States, was circulated to the Sub-Group on Subsidies and Countervailing Measures of the Negotiating Group on Non-Tariff Barriers.<sup>28</sup> This Sub-Group comprised the GATT negotiators whose efforts produced the Tokyo Round Subsidies Code. The draft contained a description of an Annex A, which would set forth an illustrative list of export subsidies:

A list of export subsidies illustrative of the obligations in GATT Article XVI:4, as supplemented by the Arrangement. In this connexion, work should build upon the 1960 Illustrative List, taking into account other work on this subject undertaken in the GATT.<sup>29</sup>

28. This description explicitly takes account of the *OECD Arrangement*, but does not mention a material advantage clause which, as of that date, had not appeared in any previous iteration of the Illustrative List, either in the OECD or in GATT. The first appearance of the material advantage clause in a GATT document did not occur until 19 December 1978, some 20 years after the other relevant language was included in the first Illustrative List of the OEEC. This document, also an Outline of an Arrangement, contained the language that was included in the Tokyo Round Subsidies Code and eventually became Item (k):

The grant by governments (or special institutions controlled by [and/or acting under the authority of] governments) of export credits at rates below those which they have to pay in order to obtain the funds so employed, or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credit, *insofar as they are used to secure a material advantage in the field of export credit terms*.<sup>30</sup>

29. Thus, sometime after deciding to include the OECD safe haven clause, the GATT negotiators then made two additional significant changes to the language contained in the 1960 Working Party

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<sup>25</sup> Ray, *supra*, at 40 (Exhibit Bra-11).

<sup>26</sup> GARY CLYDE HUFBAUER AND JOANNA SHELTON ERB, *SUBSIDIES IN INTERNATIONAL TRADE* 70 (Washington, D.C., Institute for International Economics 1984) (Exhibit Bra-12).

<sup>27</sup> Ray, *supra*, at 36-38 (Exhibit Bra-11).

<sup>28</sup> General Agreement on Tariffs and Trade, Multilateral Trade Negotiations, Group "Non-Tariff Measures," Sub-Group "Subsidies and Countervailing Duties," *SUBSIDIES/ COUNTERVAILING MEASURES*, Outline of an Arrangement, MTN/NTM/W/168, 10 July 1978 (Exhibit Bra-13).

<sup>29</sup> *Id.* page 23.

<sup>30</sup> General Agreement on Tariffs and Trade, Multilateral Trade Negotiations, Group "Non-Tariff Measures," Sub-Group "Subsidies and Countervailing Duties," *SUBSIDIES/ COUNTERVAILING MEASURES*, Outline of an Arrangement, MTN/NTM/W/210, 19 December 1978, page 26 (emphasis added) (Exhibit Bra-14).

report. First, they added the phrase "or financial institutions," and second, they added the material advantage clause: "insofar as they are used to secure a material advantage in the field of export credit terms."

30. These additions were the last changes made in the language of item (k). They were made deliberately, and were intended by their drafters to have genuine meaning and effect. In Hufbauer's words, the material advantage clause was intended to provide "a weak injury test in the event of a departure from the basic GATT standard."<sup>31</sup>

31. This history makes clear that the *expressio* – the material advantage clause – was added intentionally as a restriction on the definition of a prohibited export subsidy. Accordingly, the *exclusio* – payments that do *not* secure a material advantage – cannot have been inadvertent, as Canada suggests. Instead, the *exclusio* must be given full effect to interpret the language as it was intended – which is to exclude from the definition of prohibited subsidy instances where no material advantage is secured.

(d) Footnote 5 Does Not Control the Meaning of the First Paragraph of Item (k)

32. Canada continues to rely on footnote 5 to the Agreement, which it claims is "particularly important" to Brazil's *a contrario* argument.<sup>32</sup> 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." Canada claims "it is impossible to reach a conclusion as to the existence of an *a contrario* exception without interpreting the language of footnote 5."<sup>33</sup>

33. Brazil does not dispute that footnote 5 directs the reader to Annex I of the SCM Agreement. But that is not at issue. Rather, the issue is whether the language of footnote 5 provides any elaboration as to which measures in fact are referred to in Annex I as not constituting export subsidies. Canada believes it does, based on its view of the meaning of the words "referred to." Canada would like to read the word "expressly" into the language of footnote 5. However, as the Article 21.5 Panel noted, the word "expressly" was dropped from an earlier draft of the language of the footnote, which apparently "broadened" its meaning.<sup>34</sup> Nevertheless, Canada offers the dictionary meaning of the phrase "refers to" as "direct to . . . by drawing attention to" and synonyms such as "mentioned, cited, named."<sup>35</sup> Canada's problem is that none of these definitions is in any way inconsistent with an *a contrario* interpretation of the material advantage clause. Thus, if on review of the ordinary meaning of the language of the first paragraph, the Panel were to conclude that an *a contrario* interpretation of that language is appropriate, it would be entirely proper to consider payments that do not secure a material advantage as a "measure referred to in Annex I as not constituting [an] export subsid[y]" within the meaning of footnote 5. In short, nothing in the language of footnote 5 determines the plain meaning of item (k) first paragraph. To the contrary, that paragraph must be interpreted based on its own provisions and according to its own ordinary meaning and purpose. Once item (k) is given such an interpretation it will accord naturally with the language of footnote 5.

34. Canada attempts to avoid this analysis by bolstering the language of footnote 5, which it describes as an "explicit" exclusionary clause. But footnote 5 is not explicit in the sense used by Canada. It does not describe measures "*specifically*" or "*directly*" referred to in Annex I. Instead, it simply describes, in Canada's own words, "measures *mentioned* or *draw[n] attention to*" in Annex I.<sup>36</sup>

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<sup>31</sup> HUFBAUER, *supra*, note 26 at 70.

<sup>32</sup> Canada First Submission, paras. 47-55.

<sup>33</sup> *Id.*, para. 50.

<sup>34</sup> Original 21.5 Report, paras. 6.39-40.

<sup>35</sup> Canada First Submission, para. 52.

<sup>36</sup> *Id.*, para. 52.

Again, it does not make sense to say that item (k) "draws attention to" payments that secure a material advantage and at the same time allege that it says nothing at all about payments that do *not* secure a material advantage. For this reason also, Brazil's interpretation is more consistent than Canada's with the statement of the Appellate Body in *United States – Foreign Sales Corporations* (to which Canada cites) that footnote 5 applies "where the Illustrative List *indicates* that a measure is not a prohibited subsidy."<sup>37</sup> It is precisely Brazil's position that by limiting the description of prohibited subsidies to payments that secure a material advantage, item (k) *indicates* that payments that do not do so are not prohibited subsidies.

35. Canada seeks to elevate the importance of footnote 5 to avoid the ordinary meaning of the material advantage clause of item (k). In the words of the Appellate Body in its original opinion in this case, "[a]s a matter of treaty interpretation, this cannot be so."<sup>38</sup> Instead, the Panel should follow the Appellate Body's approach: "examine the terms of the provision at issue, in this case, the 'material advantage' clause of item (k). We look first to the ordinary meaning of the language used."<sup>39</sup>

36. Canada's arguments regarding the impact of footnote 5 on the interpretation of Annex I are undermined by the logical interpretation of other provisions of the Annex. In this regard, item (i) specifies that the remission by governments of import charges, "in excess of those levied on imported inputs," are prohibited export subsidies. *A contrario*, of course, this must mean that the remission of import charges *not* in excess of those levied on imported inputs are *not* prohibited. As with the material advantage clause of item (k), no other interpretation is reasonable. If the negotiators had intended that the remission by governments of all import charges were prohibited subsidies, item (i) simply would have been drafted with a period, or full stop, after the word "charges."<sup>40</sup>

37. In conclusion, the denial of an *a contrario* interpretation to the material advantage clause would effectively render the clause superfluous. Without an *a contrario* interpretation, the clause is totally unnecessary in the first paragraph of item (k). This reduction of the material advantage clause to inutility is not permissible under the customary rules of interpretation of public international law.<sup>41</sup> Moreover, this inutility is not avoided by reference to footnote 5, which says nothing that qualifies the meaning of the text of the material advantage clause.

38. In its opinion in the Article 21.5 proceeding, the Appellate Body stated that it "would have been prepared to find" that an *a contrario* interpretation of the material advantage clause could be used to justify PROEX payments, had Brazil been able to prove that PROEX interest rate support payments did not confer a material advantage.<sup>42</sup> Thus, as a legal matter, the Appellate Body appears to believe that the first paragraph of item (k) may be read *a contrario* to permit a payment that is not used to secure a material advantage. This Panel should reach the same conclusion.

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<sup>37</sup> *Id.*, para. 53, citing *United States – Tax Treatment for "Foreign Sales Corporations,"* WT/DS108/AB/R (20 March 2000), para. 93 (emphasis added).

<sup>38</sup> Appellate Body Report, para. 179 and footnote 110, quoting *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R (29 April 1996) (Adopted 20 May 1996), pg. 23 ("[a]n interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility").

<sup>39</sup> Appellate Body Report, para. 177.

<sup>40</sup> Brazil does not allege, and the Panel need not decide, that *every* item in the Illustrative List is susceptible to an *a contrario* interpretation.

<sup>41</sup> Appellate Body Report, para. 177.

<sup>42</sup> *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, Report of the Appellate Body, WT/DS46AB/RW (21 July 2000) ("Article 21.5 AB Report"), para. 80.

### 3. PROEX III Payments Are "Payments" within the Meaning of the First Paragraph of Item (k)

39. Canada argues that PROEX III payments are not payments within the meaning of item (k) first paragraph. Canada draws a distinction between *providing* export credits, and payment of all or part of the costs of *obtaining* export credits.<sup>43</sup> This distinction forms the basis of Canada's arguments that PROEX III interest rate support payments are not "payments" within the meaning of the first paragraph. As explained below, this distinction makes no sense in the context of the market for regional jet aircraft. Moreover, if PROEX payments do not fit the definition of "payments" contemplated by item (k), Canada fails to explain exactly what kind of payments in the export credit field the drafters of this provision had in mind.

40. The original Article 21.5 Panel stated that, "a payment by Brazil that allowed a Brazilian financial institution to provide export credits" could be permitted under the first paragraph of item (k) provided no benefit is conferred.<sup>44</sup> This would appear to contemplate that PROEX payments fell within the definition of the first paragraph, in that by enabling the Brazilian financial institution to *provide* export credits, it first had to pay the costs of *obtaining* the credits. This interpretation also would appear to be consistent with the ordinary meaning and purpose of the definition of "payments" in the first paragraph.<sup>45</sup> Canada has failed to provide any reasoned explanation why this interpretation is not appropriate.

41. The distinction between "obtaining" and "providing" credits fails for another reason. The first paragraph of item (k) refers, *inter alia*, to costs "incurred by exporters or financial institutions in obtaining credits." The language clearly contemplates that exporters and financial institutions "obtain" credits. But neither wants to "obtain" credits simply to hoard them. Both "provide" to export purchasers the credits they previously "obtain." That is the reason they are obtained. The fact that an exporter or a financial institution also provides credits does not mean that it does not obtain them at a cost.

42. The first sentence of item (k) first paragraph supports this conclusion. It deals with the grant by governments "of export credits at rates below those which they actually have to pay for *the funds so employed*." Just as the use of the term "export credits" in the first part of the paragraph justifies an interpretation of "credits" as meaning the same in the latter part, so also the reference to "the funds so employed" in the first part justifies an interpretation of the word "obtaining" in the second part as meaning "obtaining the funds [that are] so employed" when they are subsequently provided to export purchasers. This suggests that the language was intended to cover the provision of export credits to borrowers at a cost that is less than the borrower might otherwise have to pay. PROEX reduces the net interest rate to the borrower at a cost to the provider. The language of the first paragraph appears to have been designed to address precisely this type of programme.

43. Canada argues that Embraer itself does not provide export financing, and that non-Brazilian financial institutions sometimes do so. While both of these statements are factually correct, the legal conclusions reached by Canada do not follow. Canada's analysis fails totally to distinguish between situations in which the lender is a financial institution *outside* Brazil and situations in which the lender is a financial institution *inside* Brazil. Both in the original proceeding and in the Article 21.5 proceeding, Brazil carefully distinguished between these two situations, and offered very different legal justifications for each.

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<sup>43</sup> Canada First Submission, paras. 67-69.

<sup>44</sup> Original 21.5 Report, para. 6.44 .

<sup>45</sup> THE NEW SHORTER OXFORD ENGLISH DICTIONARY 2130 (1993) (A "payment is "a sum of money paid").

44. *When the lending institution is outside Brazil*, Embraer, the exporter, faces costs in obtaining for its customer a financial package that is competitive in the market. If it cannot obtain a competitive financial package for its customer, it would be forced to take other costly action such as paying for a commercially available loan guarantee at a high premium. *When the lender is inside Brazil*, it is the lender itself who must obtain the dollars on the market.<sup>46</sup> These separate justifications required separate analyses, a fact that Canada's arguments ignore. Moreover, while the question whether a payment is made to an institution inside or outside Brazil may have a bearing on the issue of material advantage, it has no bearing on the issue of payment. The payment is the same in either case.

45. Brazil risk is a genuine phenomenon that seriously handicaps financial institutions in Brazil in raising funds internationally, just as a similar risk handicaps comparable institutions in virtually all developing countries. The Article 21.5 Panel confirmed this, noting that, "developing countries' costs of borrowing are almost inevitably higher than those of developed countries."<sup>47</sup> It observed, in a footnote appended to this statement, that "[a]ccording to Brazil – and Canada has not challenged Brazil's assertion – Brazil's cost of borrowing as of 1 February 2000, based on 10-year bond yields – was more than twice that of Canada."<sup>48</sup>

46. Brazil justifies PROEX, when the lender is outside Brazil, on grounds that are totally different from those used to justify PROEX when the lender is inside Brazil. A conclusion that Brazil's justification in one instance must be rejected says nothing about Brazil's justification in the other instance. For all of these reasons, the Panel should conclude that payments under PROEX are "payments " within the meaning of the first paragraph of item (k).

#### **4. PROEX III Does Not Secure a Material Advantage**

47. The heart of Canada's argument is that even when the net interest rate for PROEX supported transactions does not fall below the CIRR, PROEX nevertheless is used to secure a material advantage in the field of export credit terms. Contrary to Canada's arguments, PROEX III payments do not confer a material advantage in the field of export credit terms on the recipient within the meaning of item (k) first paragraph.

48. Brazil already has noted that this position directly contradicts the approach taken by Canada in the previous stages of these proceedings, where Canada sought to require Brazil to limit PROEX to the CIRR, even though Canada took advantage of perceived loopholes (so-called "market window" operations) in the *Arrangement* to provide official support for transactions at rates that were below the CIRR. Thus, in its answers to the questions of the first Article 21.5 Panel, Canada unambiguously stated that "the relevant benchmark against which a net interest rate must be compared to determine whether a material advantage has been secured is CIRR."<sup>49</sup> This Panel should hold Canada to that statement.

49. In the first Article 21.5 proceedings in this matter, the Appellate Body stated that, to establish that PROEX payments are not used to secure a material advantage, Brazil must prove "*either* that the net interest rates under the revised PROEX are at or above the relevant CIRR, the specific 'market benchmark' identified in the original dispute as an 'appropriate' basis for comparison; *or*, that an alternative 'market benchmark is appropriate."<sup>50</sup> PROEX III stipulates that the net interest rates must

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<sup>46</sup> Original 21.5 Report, Annex 2-3, para. 37 (emphasis added).

<sup>47</sup> *Id.*, para. 6.58.

<sup>48</sup> *Id.*, para. 6.58, footnote 56.

<sup>49</sup> *Id.*, page 89 (Canada's Response to Question 12 of the Panel)

<sup>50</sup> Article 21.5 AB Report, para. 67 (emphasis in original).

be at or above the relevant CIRR.<sup>51</sup> Thus, PROEX III complies fully with the CIRR – the preferred benchmark of Canada, and one determined by the Appellate Body not to secure a material advantage.

50. Canada's present claim that the CIRR provides a material advantage does not withstand scrutiny. In the first Article 21.5 proceedings, Canada admitted that the CIRR was sometimes above market rates. Moreover, Canada asserted that when it offered official support at rates below the CIRR, it nevertheless was operating at market terms.<sup>52</sup> It is difficult to understand, therefore, how Canada can maintain that the CIRR is no longer an appropriate benchmark for determining whether or not PROEX III secures a material advantage.

51. Moreover, nothing in Canada's First Submission contradicts the evidence provided in Brazil's First Submission showing that the CIRR was intended to represent a market rate. Indeed, Brazil submitted evidence that, consistent with Canada's statements in the previous Article 21.5 proceedings, the CIRR presently is above the market rates, and that expert observers believe the CIRR may from time to time be higher than the market.<sup>53</sup>

52. Canada nevertheless argues that PROEX secures a material advantage because it does not reflect the rates available in the marketplace, which Canada claims demand "spreads" that put the rates available to buyers at or above the CIRR rates. This argument must fail, for several reasons. First, Brazil is entitled – indeed, effectively is required – to establish a benchmark rate and to use that rate as the benchmark in assessing applications for PROEX assistance. Canada's reaction to Brazil's decision to limit PROEX III equalization to the CIRR highlights the double standard Canada seeks to impose in these proceedings.

53. Canada also argues that PROEX III secures a material advantage because it does not comply with the other terms and conditions of the *Arrangement* governing the length of the loan and the amount of the financing. Brazil notes that it has explained in its First Submission how PROEX III complies with all applicable interest rate provisions of the *Arrangement* and therefore falls within the safe haven of the second paragraph of item (k). This includes compliance with the maximum financing amount of 85 percent of the transaction value, and with the maximum financing term of 10 years for regional jet aircraft. Thus, Canada errs in stating that PROEX III provides for 100 percent financing and an unlimited repayment period.<sup>54</sup> The terms of PROEX III, on their face, demonstrate that Canada's characterization of the measure simply is wrong.

54. Moreover, even though PROEX III by its terms is limited to 10 years, Canada is wrong to suggest that a longer term would necessarily mean that PROEX III secures a material advantage. In the previous Article 21.5 proceedings, the Panel indicated that the test of material advantage within the meaning of the first paragraph of item (k) differs from the safe haven of item (k) second paragraph, and does not require compliance with all of the provisions of the *OECD Arrangement*.<sup>55</sup>

55. By conforming to the CIRR, Brazil has established a minimum threshold that is transparent, and is set at rates that are, in the words of one expert, a "reasonable compromise in trying to formulate a proxy market rate."<sup>56</sup> As noted above, Brazil has no control over these rates or the methodology used to establish them. To the extent that the CIRR is a "proxy market rate," Brazil does not secure

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<sup>51</sup> Resolution No. 002799, Art. 1, para. 1 (Exhibit Bra-1).

<sup>52</sup> Original 21.5 Report, page 82 (Canada's Response to Questions of the Panel).

<sup>53</sup> See David Stafford, *Wallen, Helsinki, Schaerer et. Al.: Some Major Achievements, Some Challenges to Meet*, in THE EXPORT CREDIT ARRANGEMENT, ACHIEVEMENTS AND CHALLENGES 1978-1998 (OECD, 1998) (First Submission of Brazil, at Exhibit Bra-5); Presentation by Mr. Fumio Hoshi, Director-General International Finance Policy Department, Japan Bank for International Cooperation, at the Eximbank 65<sup>th</sup> Anniversary Conference, May 2000 (First Submission of Brazil, at Exhibit Bra-6).

<sup>54</sup> Canada First Submission, para. 82.

<sup>55</sup> Original 21.5 Report, para. 6.87.

<sup>56</sup> See Stafford, *supra*, Exhibit Bra-5; Article 21.5 AB Report, para. 67.

any advantage by providing equalization at the CIRR. Even if the market were to fluctuate slightly, Brazil does not secure a *material* advantage by providing equalization at this level. The ordinary market definition of "material" is "serious, important, of consequence."<sup>57</sup> Minor market deviations from the CIRR that are not "serious, important, of consequence" are not "material." The Appellate Body has noted that the term "material" cannot be read out of the language of the first paragraph.<sup>58</sup> Canada's analysis would do exactly that.

56. Finally, Canada states that the provisions of Resolution 002799, which it describes as providing for rates "in accordance with" the CIRR, do not necessarily prohibit PROEX III from supporting a minimum interest rate below the CIRR.<sup>59</sup> Brazil notes that the translation of Resolution 2799 requires interest rates "complying with" the CIRR.<sup>60</sup> Brazil reiterates that the minimum interest rate specified in PROEX III is the CIRR. This is the purpose of the Resolution. However, the CIRR is not necessarily the ceiling – Article 8, para. 2 of Resolution 002799 provides that the Committee on Export Credits is to use "as reference the financing terms practiced in the international market."<sup>61</sup> This provides additional assurance that PROEX III support will not secure a material advantage.

57. For these reasons, the Panel should conclude that PROEX III does not secure a material advantage in the field of export credit terms and that Brazil has therefore affirmatively shown that PROEX III is not a prohibited subsidy within the meaning of the first paragraph of item (k) of the SCM Agreement.

C. CANADA HAS FAILED TO SHOW THAT PROEX III DOES NOT QUALIFY FOR THE "SAFE HAVEN" OF THE SECOND PARAGRAPH OF ITEM (K)

58. In its First Submission of 16 March 2001, Brazil explained that PROEX III qualifies for the "safe haven" of the second paragraph of item (k) of the Illustrative List in Annex I of the SCM Agreement, and is therefore not a prohibited export subsidy within the meaning of the SCM Agreement. Brazil explained that PROEX III conformed to the minimum interest rate provision of the *Arrangement* – by requiring that all PROEX equalization comply with the CIRR – and also to the provisions governing the term and amount of financing – whether judged against the provisions of the 1992 *Arrangement* (as Brazil believes proper) or the provisions of the 1998 *Arrangement*.

59. As noted above, Canada does not in its First Submission address the issue whether PROEX III qualifies for the safe haven of the second paragraph. Instead, Canada addresses only the issues raised by item (k) first paragraph. However, the two paragraphs are not coterminous, and Brazil's arguments regarding the second paragraph are not undermined by Canada's arguments regarding the first paragraph.

60. The three points at issue under the first paragraph do not arise under the second paragraph. There is no need for an *a contrario* interpretation of the second paragraph, which states affirmatively that "if in practice a Member applies the interest rate provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement." Accordingly, Canada's arguments regarding the *a contrario* issue are not relevant to the issue whether PROEX III qualifies for the safe haven of the second paragraph of item (k).

61. Similarly, the "payment" issue raised by Canada regarding the first paragraph of item (k) is irrelevant in the context of the second paragraph. Regardless of whether PROEX III meets the

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<sup>57</sup> The New Shorter Oxford Dictionary 1713-14 (1993).

<sup>58</sup> Appellate Body Report, para. 177.

<sup>59</sup> Canada First Submission, para. 71.

<sup>60</sup> First Submission of Brazil, para. 7, Exhibit Bra-1.

<sup>61</sup> Id.

definition of "payments" within the first paragraph, PROEX III is indisputably an "export credit practice" as contemplated by the second paragraph of item (k). As the Article 21.5 Panel in *Canada – Aircraft* stated, "we can conceive of no basis to consider any practice associated with export credits as *a priori* not constituting an 'export credit practice' in the sense of the second paragraph of item (k)."<sup>62</sup> It is not disputed that Brazil's practice of providing interest rate support is an "export credit practice" of the kind long practiced by various members of the OECD.<sup>63</sup>

62. Finally, the issue whether the PROEX III payments are used to "secure a material advantage in the field of export credit terms" does not arise under item (k) second paragraph. There the issue is not whether the PROEX interest rate support payments are used to secure a material advantage, but rather whether Brazil complies with the interest rates provisions of the *Arrangement*. Canada's arguments that the CIRR may not accurately reflect the market<sup>64</sup> are quite simply irrelevant to the issue whether PROEX III, by its terms, conforms with the interest rate provisions of the *Arrangement* and therefore qualifies for the safe haven of the second paragraph of item (k).

## V. CONCLUSION

63. For all of the reasons given in Brazil's First Submission and in this Submission, the Panel should conclude that:

- (a) Canada has not sustained its burden of proving that PROEX III is a subsidy within the meaning of Article I of the SCM Agreement;
- (b) Alternatively, even if PROEX III were considered to be a subsidy, it complies with the interest rates provisions of the relevant *OECD Arrangement* and is, therefore, covered by the "safe haven" of item (k) second paragraph;
- (c) Further, even if PROEX III were considered to be a subsidy, and even if it were not eligible for the safe haven of item (k) second paragraph, PROEX III is not used to secure a material advantage in the field of export credit terms within the meaning of item (k) first paragraph.

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<sup>62</sup> Canada – Measures Affecting the Export of Civil Aircraft – Recourse by Brazil to Article 21.5 of the DSU, Report of the Panel, WT/DS70/RW (9 May 2000), para 5.81.

<sup>63</sup> Ray, *supra*, at pp. 22-24.

<sup>64</sup> The OECD members clearly intended that the CIRR would indeed reflect market rates. Members that are not participants in the *OECD Arrangement*, such as Brazil, have no control over these rates and should not be punished when they comply with the rates only to have OECD participant Members decide that the CIRR rates do not suit their purpose after all.

**LIST OF EXHIBITS**

- BRA-10. Steve Cutts and Janet West, "The Arrangement on Export Credits," *The OECD Observer* No. 211, April/May 1998
- BRA-11. JOHN E. RAY, MANAGING OFFICIAL EXPORT CREDITS – THE QUEST FOR A GLOBAL REGIME, Institute for International Economics (1995)
- BRA-12. GARY CLYDE HUFBAUER AND JOANNA SHELTON ERB, SUBSIDIES IN INTERNATIONAL TRADE 70 (Washington, D.C., Institute for International Economics 1984)
- BRA-13. General Agreement on Tariffs and Trade, Multilateral Trade Negotiations, Group "Non-Tariff Measures," Sub-Group "Subsidies and Countervailing Duties," SUBSIDIES/COUNTERVAILING MEASURES, Outline of an Arrangement, MTN/NTM/W/168, 10 July 1978
- BRA-14. General Agreement on Tariffs and Trade, Multilateral Trade Negotiations, Group "Non-Tariff Measures," Sub-Group "Subsidies and Countervailing Duties," SUBSIDIES/COUNTERVAILING MEASURES, Outline of an Arrangement, MTN/NTM/W/210, 19 December 1978

**ANNEX B-3**

**ORAL STATEMENT OF BRAZIL**

(4 April 2001)

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1. Mr. Chairman, Brazil welcomes this opportunity to present its views to the Panel, and to answer any questions that you may have. We very much appreciate your continuing efforts in this complicated and prolonged dispute, and we hope that this review will be the end of your – and our – work on this matter.

2. The issue before you is a straight forward legal issue: is PROEX III – by its terms, on its face, as a matter of law – consistent with Brazil's obligations under the *Agreement on Subsidies and Countervailing Measures*?

3. In its First Submission, Brazil has presented three reasons why PROEX III is in conformity with the Subsidies Agreement:

*First*, PROEX III does not confer a benefit, and therefore is not a subsidy within the meaning of Article I of the Agreement;

*Second*, totally apart from the question of benefit, PROEX III is entitled to the "safe haven" of the second paragraph of item (k) of Annex I to the Agreement;

*Third*, totally apart from the question of benefit and the safe haven, PROEX III does not secure a material advantage in the field of export credit terms, within the meaning of the first paragraph of item (k).

**I. CANADA HAS NOT ESTABLISHED THAT PROEX III IS A SUBSIDY**

4. Let me first address the question of subsidy – the benefit issue. It is for Canada to prove, by positive evidence, that PROEX III, on its face, confers a benefit and therefore constitutes a subsidy. It

is not Brazil's obligation to prove the negative, to prove that PROEX III does not confer a subsidy. Canada has failed to sustain its burden of proof on the question of benefit, and the efforts of the European Communities and the United States, as third parties, to support Canada on this question are not successful.

5. Canada's "proof" as to benefit consists of several descriptive statements about PROEX I and PROEX II, which are not relevant to this proceeding, and allegations concerning Brazil's development bank, Banco Nacional de Desenvolvimento Economico e Social ("BNDES"). We are somewhat confused by Canada's reference to BNDES, Mr. Chairman, and by the point Canada attempts to make. BNDES has never been within the terms of reference of this dispute. In any event, statements about PROEX I, PROEX II, or BNDES are not evidence establishing that PROEX III confers a benefit.

6. In the absence of evidence, Canada resorts to faulty logic. For example, at paragraph 12 of its Second Submission, Canada argues that "PROEX III, like its predecessor schemes, is constructed as a buy-down of interest rates that have already been freely negotiated by the recipients – Embraer's customers – in the marketplace." Canada then concludes that *any* buy-down below those freely negotiated rates will *necessarily* result in net interest rates on terms more favourable than those available to Embraer's customers in the market."

7. It is misleading, if not inaccurate, to say that PROEX III is a buy-down of interest rates that have already been freely negotiated by the recipients in the market place. PROEX III is limited, on its face, to a maximum payment of 2.5 percent, with a minimum rate of the CIRR, and is, further, subject to being "compatible with [financing costs] practiced in the international market." PROEX is *not* a system, as Canada seems to suggest, whereby the customer negotiates for the most favorable rate, and then receives a "buy-down" of 2.5 percent. To the contrary, PROEX is part of the transaction itself – a transaction that is *limited* by the market, as reflected in the CIRR, a 10-year term, and 85 percent maximum financing, and by the requirement that the resulting transaction be compatible with the international market.

8. Thus, PROEX most certainly does *not* "necessarily result in net interest rates terms more favourable than those available to Embraer's customers *in the market*." Whether the resulting net interest rate terms are or are not more favourable than those a customer could obtain "in the market" is a question of fact. PROEX III does not provide for rates that are more favorable than those a customer could obtain "in the market." The theoretical possibility that more favourable terms could be offered in some future transaction is not evidence that they would be offered, and is not relevant to the question of what PROEX III, on its face, as a matter of law, provides.

9. The Panels in the *Canada – Aircraft* cases, for example, pointed out that the fact that Canada's export credit agency, the Export Development Corporation – "EDC" – *could* provide financing on a preferential basis, does not mean that it *would* do so. Those Panels also pointed out that the mere fact that Canada's Technology Partnerships Canada *could* provide a subsidy contingent on export, does not mean that it *would* do so. Likewise, the theoretical possibility that PROEX III *could* provide terms more favorable to a customer than could be obtained in the market does not mean that PROEX III *would* so provide.

10. Canada claims that financing being provided by BNDES – which, as I have already noted, is not and never has been within the terms of reference for this dispute – is being offered "in conjunction with PROEX III." There are several problems with this claim. First, it is simply irrelevant whether BNDES is involved in financing Brazilian aircraft transactions. The second is that Canada's "evidence" in support of its claim is a statement by a Bombardier employee reporting on what an airline official allegedly told the Bombardier employee that Embraer allegedly offered to the airline.

11. In law, this kind of evidence is what is referred to as "hearsay" – that is, it is the mere repetition of what someone claims to have heard another say. In this case, what Canada is offering is

"triple hearsay" – (1) Canada's statement of what a Bombardier employee said about (2) what an airline official said about (3) what Embraer said.

12. Now, Brazil is willing to acknowledge, Mr. Chairman, that just because evidence is hearsay, even triple hearsay, does not necessarily mean that it is always wrong. But Brazil does suggest that the possibility for error in such a lengthy transmission is high, particularly given the fact that an airline, in this situation, might be said to have an incentive to exaggerate in its statements to one potential vendor about what another potential vendor is offering.

13. Finally, there is an overriding reason why this evidence is not relevant. It is at most evidence of what an *Embraer sales person* said. The Government of Brazil cannot take responsibility for the alleged statements of Embraer sales persons.

14. Canada concludes its "evidence" on benefit with the statement, in paragraph 17, that "Canada demonstrated in its First Submission that the CIRR alone, divorced from the other terms and conditions of the OECD Arrangement such as the ten-year term limit and the limit on financing to 85 percent of the value of the contract, in no way reflects market realities. Brazil has not rebutted Canada's evidence and submissions on this point."

15. This is a rather surprising statement, Mr. Chairman. As I thought we made clear in our First Submission, PROEX III is not "divorced" from the 10-year term limit and the limit on financing to 85 percent of the value of the contract. PROEX III specifically includes these requirements.

16. Indeed, if another piece of Canada's hearsay evidence is to be believed, Brazil is financing considerably less than 85 percent of the value of the contract. Canada's Exhibit 27 is more triple hearsay – a statement of (1) what another Bombardier employee said that (2) another airline official said about (3) what Embraer allegedly offered. This evidence shows, however, that the amount of the financing allegedly offered by Embraer was far less than 85 percent. This hardly seems to be a "benefit," even under Canada's definition.

17. Canada is also incorrect to say that the only change in PROEX III is to ensure compliance with the CIRR. To the contrary, PROEX III now also requires that the Committee on Export Credits use "as reference the financing terms practiced in the international market."

18. In paragraph 10 of its Second Submission, Canada accused Brazil of failing to recognize the "critical distinction" between "benefit" and "material advantage." In paragraph 17 of that same submission, Canada states that paragraphs 87 to 90 of its First Submission demonstrate that PROEX III confers a benefit. However, the heading to the section of Canada's First Submission that contains paragraphs 87 to 90 refers only to "material advantage." It does not refer to "benefit." Thus, to employ the "critical distinction" between "benefit" and "material advantage," paragraphs 87 to 90 of Canada's First Submission do not bear upon the issue of "benefit" at all.

19. More importantly, paragraphs 87 to 90 of Canada's First Submission do not contain any factual evidence regarding PROEX III. They contain only assertion and argument. The only one of those paragraphs remotely referring to anything specific is paragraph 88, which asserts that the CIRR "cannot be conclusive on the issue of material advantage because it does not ... take into account other aspects of the transaction, (*i.e.*, maturity, the loan-to-asset value or minimum cash payment to be made, etc.) and the creditworthiness of the borrower."

20. But PROEX III does take these factors into account, Mr. Chairman. By its terms, PROEX III has a 10-year maximum repayment term. By its terms, PROEX III is available only for 85 percent of the value of the transaction. By its terms, PROEX III transactions must be compatible with the terms available in the international market, which includes the creditworthiness of the borrower. Canada simply has not carried its burden of proving the contrary.

21. The arguments of the third parties do not advance Canada's case. The European Communities, at paragraph 12 of their submission, repeat Canada's claim that PROEX is used to reduce a commercially negotiated contract by 2.5 percent. I have already pointed out why this reasoning is wrong. At paragraph 14, the European Communities claim that the CIRR is a rate that would be available to borrowers only in the presence of a guarantee or other security. But all transactions involving aircraft are secured – by the aircraft themselves, if not by other means, such as residual value guarantees.

22. The United States, at paragraph 11, "wishes to note only that interest rate support at or above CIRR does not, *ipso facto*, mean no benefit is conferred." This formulation reverses the issue. It is not for Brazil to show that no benefit is conferred. It is for Canada to show, affirmatively and by positive evidence, that a benefit *is* conferred.

23. The United States, at paragraph 12, also raises the point of the creditworthiness of the borrower, a subject I already have addressed. To support its position, in paragraph 13 the United States refers to Article 14(b) of the Agreement. However, as a matter of substance, PROEX III does not provide a loan below a comparable commercial loan which the borrower could actually obtain on the market, as the United States claims. PROEX III, by its terms, must be compatible with the market. Neither Canada, nor the United States, nor the European Communities has provided any evidence to support their claims. On a more technical point, Article 14 is part of Part V of the Agreement, dealing with countervailing duties. The *chapeau* of Article 14 specifies that it applies only "For the purpose of Part V ..." By definition, therefore, it does not apply to Part I of the Agreement, dealing with the existence of a subsidy.

## **II. BRAZIL QUALIFIES FOR THE "SAFE HAVEN" IN ITEM (K) SECOND PARAGRAPH**

### **A. THE 1992 VERSION OF THE *OECD ARRANGEMENT* IS THE RELEVANT VERSION**

24. I would like to turn now, Mr. Chairman, to the safe haven provisions of the second paragraph of item (k). While PROEX III does not confer a benefit, it also applies in practice the interest rates provisions of the *OECD Arrangement on Export Credits* that are referred to in the second paragraph. PROEX III therefore qualifies for the safe haven.

25. The first issue presented by the second paragraph is: What version of the *Arrangement* applies? Is it the version that was in effect at the time it was incorporated by reference into the SCM Agreement, or is it any future version that the OECD issues?

26. In its First Submission, Brazil has demonstrated that the version of the *Arrangement* that is relevant to this dispute is the 1992 version, the version that was in effect at the time of adoption of the SCM Agreement. I will not repeat those arguments in detail, but let me just mention the main points.

27. Following Article 31 of the Vienna Convention, Brazil first addressed the relevant text of the second paragraph. Brazil pointed out that the second paragraph refers to a "successor undertaking which *has been* adopted" by the original Members of the *Arrangement*. The crucial phrase, "has been," is in the present perfect tense and refers to a time present, not to a future time. It says "has been," not "will be" or "may be." Therefore, the reference is to the version in existence at the time it was incorporated by reference into the SCM Agreement.

28. Second, Brazil examined the context of the second paragraph, a context that includes the detailed requirements for amending any of the WTO agreements, including the SCM Agreement, and a context that provides, through Article 3.2 of the Dispute Settlement Understanding, that rulings and recommendations of the Dispute Settlement Body "cannot add to or diminish the rights and obligations" of Members. Brazil also pointed out that Article 30 of the Vienna Convention provides

that an existing treaty *may* be subject to the terms of a later treaty, but only when the terms of the existing treaty "specify" that this is the case.

29. Further, as part of the context, Brazil referred to the fact that, in the case of Members that incorporate the WTO Agreements into their domestic law, serious constitutional questions would be raised if later versions of the *Arrangement* were included in the second paragraph of item (k). This would amount to a *carte blanche* to non-citizens to change the domestic law of these Members. It is not only Brazil that would be in this position, Mr. Chairman. A substantial number of Members incorporate WTO Agreements directly into their domestic law.

30. Third, Brazil noted the object and purpose of the SCM Agreement. While the Agreement does not, on its face, contain a statement of its object and purpose, there can be little dispute that these include establishing disciplines for the conduct of Members in providing subsidies – disciplines that are clear, transparent, and fair.

31. There is nothing clear, transparent or fair about an interpretation of the second paragraph that would permit a small group of developed countries to change the terms of the SCM Agreement anytime they choose, in whatever way they choose. Certainly there is nothing fair about an interpretation that, for example, would allow Canada and the other participants in the *Arrangement* to provide that interest rate support may not be used for regional aircraft. Canada, however, seems to think there is nothing wrong with this.

32. This is not a theoretical risk, Mr. Chairman. I will have more to say about the question of spare parts shortly, but for now let me just note that the handling of spare parts by the participants in the *Arrangement* is a clear example of how Canada would have the system work. Under the 1992 version of the *Arrangement*, its spare parts provisions did not apply to regional aircraft. Under the 1998 version, they do apply – and Canada is citing those provisions as grounds for excluding Brazil from the safe haven of the second paragraph.

33. The sequence of events in this dispute and in the change in the terms of the *Arrangement* is very significant. Let's assume, for purposes of analysis of these events, that the spare parts provision of the *Arrangement* is an interest rate provision, and that PROEX III does not in practice apply that provision – (as I will explain later, Brazil does not agree with either of these assumptions).

34. In 1995, when the SCM Agreement was adopted, Brazil would not have had to apply the spare parts provision in order to be in compliance with the second paragraph, since the provision explicitly did not apply to regional aircraft in the version of the *Arrangement* in effect at that time. In 1996, when Canada began this dispute with its request for consultations, Brazil still would not have had to apply the provision, since the 1992 version remained in effect.

35. In 1997, while Brazil and Canada were engaged in negotiations with a view to settling these disputes without formal proceedings, Canada was also engaged in negotiating a new version of the *Arrangement* which came into effect in 1998, the year this case began. Brazil had no knowledge of these OECD negotiations or of their results. Brazil had no knowledge that the rules Canada – as well as the EC and the US – say apply to Brazil under the second paragraph had been changed, by, among others, Canada, the EC, and the United States.

36. Even today, Mr. Chairman, Brazil understands that the OECD participants are discussing rules governing export credits that employ floating rates that would be added to the *Arrangement*. Brazil's understanding, I must emphasize, does not come from any official notification, but merely from press reports. Brazil, the WTO, and non-participants are not notified whether the participants in the *Arrangement* are discussing floating rates, or any other issue, and have no say in formulating the rules that Canada argues would be binding on all of them.

37. From further press reports, Mr. Chairman, Brazil has learned that environmental and labour standards are on the agenda of the participants in the *Arrangement*. The Panel should not adopt an interpretation of the second paragraph of item (k) that would permit participants in the *Arrangement* to smuggle environmental or labour standards into "interest rates provisions" by, for example, permitting concessionary financing for aircraft or other products that are "environmentally friendly" or that are made under "fair" labour standards.

38. These events led to the fourth point Brazil made on the question of which version of the *Arrangement* is relevant. Brazil referred to Article 32(b) of the Vienna Convention, which provides that an interpretation that "leads to a result which is manifestly absurd or unreasonable" should be avoided. I shall have more to say about this in a moment. First, let me deal with the replies of Canada and the third parties to Brazil's first three points – the text, the context, and the object and purpose of the relevant treaty language.

B. THE ARGUMENTS OF CANADA, THE EC AND THE US DO NOT REBUT BRAZIL'S ARGUMENT THAT THE 1992 VERSION OF THE *OECD ARRANGEMENT* IS RELEVANT

39. What is Canada's answer to these arguments? First, Canada argues that the phrase "has been" refers to the "time regarded as present" when the financing in question takes effect, not when the *Arrangement* was incorporated into the SCM Agreement. Thus, Canada views "has been" as a perpetually moving goal post that will always be in the present tense. Canada's interpretation requires the conclusion that the negotiators adopted this convoluted approach instead of saying "will be adopted" or "may be adopted." There is no justification for such an interpretation.

40. Canada makes much of the fact that the second paragraph refers to a successor undertaking that has been adopted by the *original* 12 Members of the *Arrangement*. Brazil is happy to concede this point. Brazil had suggested, in its First Submission, that under Canada's approach the 23 participants in the *Arrangement* would have the power to change the terms of the SCM Agreement for the entire 140-plus Membership of the WTO. We are now informed that the situation is worse than that, and that if Canada and the EC and the US have their way, it will take only 12 participants in the *Arrangement* to make the change, 12 that include, by coincidence, Canada, the US and many Member States of the EC.

41. Canada also makes much of the fact that the text of the second paragraph appears in the 1979 GATT Subsidies Code. This is true, but it begs the question of which version applies to the WTO. In fact, it also begs the question of which version applied in GATT, since that issue was never presented to a GATT panel or to the CONTRACTING PARTIES for interpretation.

42. Canada concludes its rebuttal to Brazil's argument by stating that the drafters could have referred to the 1992 version, but did not do so, and that the *Canada-Aircraft* Article 21.5 Panel assumed that the 1998 version applied. Both of these statements are accurate, but they hardly resolve the issue.

43. What the drafters *could* have said does not address the meaning of what in fact they did say. They said, "has been" adopted – in the present perfect tense, meaning at a time present on 1 January 1995. As to what they *could* have said, I have already noted they could have said "will be" adopted or "may be" adopted, if that is what they meant. They did not use those terms – they said "*has been*."

44. Brazil notes that the Spanish and French versions of the SCM Agreement support the argument that item (k) refers to a situation that occurred before 1 January 1995. The "*has been adopted*" expression is found in the Spanish text in a past tense construction (*pretérito perfecto de subjuntivo*): "*haya sido aceptado*." Similarly, the French text uses the *passé composé* formulation: "*a été adopté*." It is evident that both texts, in using the past tense formulation, support Brazil's interpretation that a reference is being made to an event that happened before the Agreement entered

into force. Once again, the drafters could have said "will be," or "may be" adopted. But they said "has been," "haya sido," "a été" adopted.

45. While the *Canada-Aircraft* Panel did discuss the 1998 version of the *Arrangement*, the question of which version was relevant was never at issue in that proceeding. The parties neither briefed nor argued the question. It was not discussed by the parties in their meetings with the Panel. Consequently, that Panel's assumptions, which are not binding on this Panel, were clearly for the purpose of addressing the issue before it. That issue is not the issue here.

46. This ends Canada's rebuttal to Brazil's arguments. Canada did not address Brazil's arguments regarding the context of the second paragraph, particularly in light of the amendment provisions of the WTO Agreement. Canada did not address the object and purpose of the SCM Agreement, which, at a minimum, includes clarity, transparency, and fairness. Canada did not address Brazil's argument under Article 32(b) of the Vienna Convention that an interpretation of the second paragraph that applies the 1998 and all later versions of the *Arrangement* leads to a result that is manifestly absurd and unreasonable.

47. Even assuming that the interpretation advocated by Canada is a possible interpretation of the "has been adopted" clause of item (k) second paragraph, there can be no dispute that, at the very least, the interpretation advocated by Brazil also is a possible interpretation of that clause. In such circumstances, the Panel should adopt the interpretation that avoids an absurd or unreasonable result. There is nothing in the text of item (k) that unequivocally specifies that WTO Members have given a few countries the right to *perpetually* legislate on behalf of the overwhelming majority of the membership.

48. The third parties do not salvage the situation for Canada. The United States repeats Canada's moving goal post argument, that "has been" refers to the time when an export credit is granted. The United States then goes on to say, at paragraph 7, that Brazil's interpretation is illogical "since it would suggest that a Member could grant export credits that are not in compliance with the most recent version of the *Arrangement*, and yet still benefit from the safe harbour in item (k)."

49. Brazil sees nothing illogical at all in this, Mr. Chairman. There is nothing illogical in an interpretation of the second paragraph to mean that all WTO Members are bound by the version of the *Arrangement* in effect at the time when it was incorporated into the SCM Agreement. If other Members – whether 23 of them or only the original 12 – wish to agree to stricter standards among themselves, then by all means they are free to do so. What is illogical, Mr. Chairman, is an interpretation of the second paragraph that would permit 12 or 23 OECD participants to change the terms of the SCM Agreement for all of the WTO Members.

50. The United States addresses Brazil's fairness point by referring to Article 27 and its temporary exemption from Article 3's prohibition for developing countries. Article 27 is hardly relevant to the interpretation of the second paragraph of item (k). Moreover, as the Panel knows, Article 27 has strict conditions for the exemption. Further, the exemption expires in two years, as the United States admits. Article 27 does not justify permitting 12 or 23 OECD participants to make rules for the entire WTO.

51. The United States further argues that the drafters of the Tokyo Round Subsidies Code, referring to the *Arrangement* as of 1 January 1979, and then to a "successor undertaking," clearly referred to a successor undertaking adopted after the Tokyo Round. Following the very same logic, however, the drafters of the Uruguay Round Subsidies Agreement should have referred to the *Arrangement* "as of 1 January 1995" and then to a "successor undertaking." They did not do that. Thus, what may have been clear and explicit in 1980 (and Brazil does not agree that it was) is at best unclear and ambiguous in 1995. In fact, the Tokyo Round Code came into effect on 1 January 1980, a full year after the 1 January 1979 effective date of the *Arrangement*. The reference in item (k) of the

Tokyo Round Code to a "successor undertaking," in Brazil's view, is a reference to any possible further action within the OECD that might have been taken during that year.

52. The European Communities repeats the arguments raised by Canada and the US, and then adds two of its own. First, the EC argues that a change in the *Arrangement* does not amend the SCM Agreement since the text of the second paragraph itself is not changed by action in the OECD. This argument ignores the fact that, by virtue of the second paragraph, the *Arrangement* becomes a WTO text, just as the major intellectual property conventions are WTO text (in their 1995 versions only), and just as the Lomé Convention was found to be a WTO text by the Panel in *Bananas* because it was incorporated by reference into the WTO by means of a waiver. A change in these documents is a change in the relevant WTO text. Indeed, the EC concedes as much. At paragraph 30, the EC observes, "It may appear strange that the WTO Members should have agreed to apply a *text* that could only be changed by a small number of them." That it is a *text* that applies to the WTO that is being changed cannot be doubted.

53. I have already given a concrete example of how, under Canada's theory, WTO obligations could be changed by a change in the *Arrangement* – the example of the spare parts provisions, which indisputably did not apply to regional aircraft in the version in existence on 1 January 1995, and which undisputedly do apply to regional aircraft in the current version. It is difficult to imagine a clearer example of an effective change in a WTO text. The fact that a text was adopted by the WTO, rather than being written by it, does not mean that it is not a WTO text.

54. The second argument made by the EC that differs from the arguments made by Canada and the US concerns other parts of the WTO Agreements that may authorize action by other international organizations. The EC points to Article XXI of GATT 1994, which allows Members to take action in pursuance of their obligations under the United Nations Charter for the maintenance of international peace and security. It also points to the TBT and SPS Agreements, which require Members to take international standards into account in setting their own standards. For that matter, the EC could have pointed to Articles XIV and XV of GATT 1994, which make certain decisions of the International Monetary Fund applicable to WTO Members.

55. These are all true and, equally, these are all irrelevant for the issue before you concerning the second paragraph of item (k).

56. Brazil has never disputed that international organizations *may* specify that the provisions or decisions of other treaties or organizations shall apply. The question is whether, in a particular instance, this has been done. In the case of giving overriding authority to the United Nations on matters of peace and security there can be little argument. GATT 1994 explicitly does so specify. It is worth pointing out, as well, that all Members of the WTO are eligible for membership in the UN, and most, if not all of them, are members. Similarly, GATT 1994 gives certain powers to the International Monetary Fund. These powers relate to balance of payments issues and were included in GATT 1947 in the context of the entire Bretton Woods system, which sought to combine freer trade with fixed exchange rates. There was an obvious need for cooperation among the organizations, as fixed exchange rates and import quotas established to protect those rates, could have had an obvious impact on the trading system. Again, it is worth pointing out that all Members of the WTO are eligible for membership in the IMF, and most, if not all of them, are members.

57. With regard to the TBT and SPS Agreements, the EC greatly overstates its case. It is true, as the EC states, that provisions of both Agreements call upon Members to base their standards on international standards. But it is also true that each of those provisions contains exceptions; Members are not required to follow international standards in order to comply with their WTO obligations. It is further true that other paragraphs of the same articles of those Agreements, cited by the EC, call upon WTO Members to play a full part in the international standard-setting organizations, which are open to membership by all nations. There are no comparable exceptions in the second paragraph of

item (k), and all WTO Members most certainly are not called upon by that paragraph to play a full part in the OECD. Most WTO Members are not eligible to join the OECD and, even if eligible, any effort to join would be rejected.

58. Finally, the EC disagrees with Brazil's argument that changes in the *Arrangement* occur in a non-transparent manner. "The current version of the *OECD Arrangement* is publicly disclosed by the OECD," the EC writes at paragraph 29, "and is available on the OECD web site." In a footnote to this statement, the EC is good enough to supply the internet address of the OECD.

59. Mr. Chairman, it is Brazil's position that Members of the WTO should not be required to check the web site of the OECD to learn what their WTO obligations are. An interpretation of the second paragraph of item (k) that results in such a requirement would, in the view of Brazil, be a result that is manifestly absurd and unreasonable within the meaning of Article 32(b) of the Vienna Convention. That interpretation should be rejected.

C. PROEX III COMPLIES WITH THE INTEREST RATES PROVISIONS OF BOTH THE 1992 AND 1998 VERSIONS OF THE *ARRANGEMENT*

60. Mr. Chairman, I will not take the time to repeat here the points made in Brazil's First Submission that demonstrate that Brazil is in compliance with the interest rates provisions of both the 1992 and the 1998 versions of the *Arrangement*. Instead, I will address only the points raised by Canada regarding Brazil's alleged failure to apply those provisions, in practice, through PROEX III. The third parties, I note, did not address the specifics of Brazil's argument concerning its application of the interest rates provisions, but rather addressed the broader question of what, in fact, are the interest rates provisions – a subject Brazil addressed in its First Submission.

61. At paragraph 50 of its Second Submission, Canada claims that PROEX III does not conform to what it calls two of the key requirements of both the 1998 and 1992 versions of the *Arrangement*. These are the requirements that support be limited to terms of 10 years and cover no more than 85 percent of the value of the goods financed.

62. But PROEX III, on its face, complies with these requirements. As Brazil noted in paragraph 9 of its First Submission, and as set out in Brazil's Exhibit 3, Directive 374 limits PROEX interest rate equalization to 85 percent of the value of the transaction, and establishes a maximum financing term of 10 years for regional jet aircraft. Thus, even by Canada's definition, Brazil in practice applies the interest rates provisions of the 1992 version of the *Arrangement* – and also applies at least these two provisions of the 1998 version as well.

63. The only other specific provisions of the 1998 version cited by Canada as not being addressed by PROEX III are Article 13 regarding repayment of principal and Article 29(a)-(c) of Annex III regarding spare parts. Let me address each of these in turn.

64. Article 13 of the *Arrangement* is entitled "Repayment of Principal." It does not even deal with interest – it deals only with principal. Even the *Canada-Aircraft* Panel, which took, in our opinion, an overly-broad view of the term "interest rates provisions" did not include Article 13 among them. Very plainly, Article 13 is not an interest rate provision.

65. The *Canada-Aircraft* Panel did identify Article 29(a)-(c) as among the interest rates provisions of the *Arrangement*. Brazil disagrees in part. Only the first sentence of Article 29(a) deals with interest rates, providing that the financing of spare parts "when contemplated as part of the original aircraft order may be on the same terms as for the aircraft." Brazil complies with this provision. To the minimal extent that spare parts are part of an Embraer order, PROEX III provides that they should be financed on the same terms as the aircraft – at the CIRR, with a maximum of 85 percent financing, for 10 years.

66. However, the remainder of Article 29(a) as well as all of (b) and (c) do not deal with interest rates. The remainder of (a) deals with the size of the fleet of each aircraft type, which has nothing to do with interest rates. Similarly, paragraphs (b) and (c), like Article 13 of the *Arrangement*, deal with repayment terms. These also have nothing to do with interest rates.

67. Canada's remaining objections to Brazil's compliance with the 1998 version concerns Brazil's alleged failure to conform to Articles 16 through 19 of the *Arrangement*. Canada offers no evidence, argument or explanation for its contention, no doubt because Canada cannot do so. The contention is without merit.

68. Article 16 deals with the construction of CIRRs. Brazil does not construct CIRRs. It follows and applies them, particularly the CIRR constructed by the United States for the dollar. Article 17, at first glance, may appear more relevant since it deals with the application of CIRRs. However, Article 17(a) is not relevant because PROEX does not fix the interest rate. Article 17(b) also is not relevant, as it deals with floating rates and PROEX III, by its terms, applies only to fixed rates. Articles 18 and 19 concern cosmetic interest rates, which are at rates below the CIRR. PROEX III, by its terms, sets the CIRR as the minimum. In Brazil's view the term "cosmetic interest rates" might better be applied to the so-called "market window" operations engaged in by Canada in order to evade its obligations under the *Arrangement* than to an interest rate, like PROEX III, that, on its face, is limited by the CIRR.

69. Brazil has addressed the question of just what are the interest rates provisions of the *Arrangement* in its First Submission. In Brazil's view, the term should be interpreted narrowly primarily because the text itself calls for a narrow interpretation. But if the Panel were to conclude that the 1998 version of the *Arrangement* is the relevant version, the case for a narrow interpretation would be all the more compelling.

70. Accordingly, Mr. Chairman, Brazil, through PROEX III, "in practice" "applies" the interest rates provisions of both the 1992 and the 1998 versions of the *OECD Arrangement*.

### **III. PROEX III DOES NOT SECURE A MATERIAL ADVANTAGE WITHIN THE MEANING OF ITEM (K) FIRST PARAGRAPH**

71. Finally, Mr. Chairman, I will turn – briefly – to the first paragraph of item (k). This is a subject we all have been through many times, so I will attempt to minimize repetition of points that are familiar to us all.

72. The parties, and the Panel in its previous reports, appear to agree that in order for Brazil to invoke the first paragraph of item (k) successfully, it must establish three points. First, as a matter of legal interpretation, the first paragraph may be interpreted *a contrario*. Second, that a PROEX payment is a "payment" within the meaning of the first paragraph. And third, that the payment is not used to secure a material advantage in the field of export credit terms.

73. On the question of an *a contrario* interpretation: Brazil has pointed out in its submissions in this proceeding and in prior proceedings, that failure to interpret the first paragraph of item (k) *a contrario* renders treaty language superfluous. This is not a permissible interpretation under the tests established by the Appellate Body. Korea has made this point in its Third Party Submission. And Korea has noted, as did Brazil in its Second Submission, that the Appellate Body, in its report in the original Article 21.5 dispute, indicated that it was prepared to interpret the first paragraph *a contrario*. The Panel should do the same.

74. On the question of payment: Brazil also has pointed out in its prior submissions that PROEX is a payment of all or part of the costs of exporters or financial institutions in *obtaining* the credits they *provide*. Material advantage occurs, if it occurs at all, when those credits are provided to the

customers. This interpretation is supported by the structure and logic of the first paragraph of item (k), which addresses two kinds of subsidies. The first kind of subsidy is the grant by a government itself of credits below its own cost of funds. The relevant issue here is the cost to the government in obtaining the funds *it* provides. The second kind of subsidy is governmental assistance to defray all or part of the costs incurred by exporters or financial institutions in obtaining the funds *they* provide. In both situations, funds provided are first obtained. In fact, the parenthetical clause in the first paragraph, describing the proper measure of the government's cost in obtaining funds is a description of the costs incurred by exporters or financial institutions in obtaining credits that PROEX is intended to address. This clause refers to costs that actually are paid or would have to be paid "on international capital markets in order to obtain funds of the same maturity ... denominated in the same currency as the export credit." Almost all PROEX payments are made to banks in Brazil that incur costs in obtaining dollars on international capital markets.

75. The United States supports Brazil's position on the definition of "payment" in the first paragraph of item (k). The United States points out that the term covers not only direct payments, but also payments that reduce the risk incurred by the exporter or the financial institution. Therefore, in the view of the United States, PROEX interest rate support is a "payment" under the first paragraph of item (k). Brazil agrees. In addition, the United States correctly observes that the first paragraph of item (k) should be interpreted within the context of the Agreement and general export credit practice. Interest rate support payments, like PROEX, reduce the risk incurred by exporters or financial institutions, just as such practices as insurance and guarantees reduce the risk.

76. In Brazil's view, one way to look at the payment issue is to go back to the original 1958 language of the OEEC, which is set out in paragraph 24 of its Second Submission: "The government *bearing all or part of the costs* incurred by exporters in obtaining credits."

77. This was the initial description of an export subsidy, that eventually found its way into item (k) first paragraph. One of the 1979 additions to this language was the inclusion of "financial institutions" as well as exporters as the target recipients of what were deemed export subsidies. This extended the original 1958 prohibition, which covered only suppliers' credits, to buyers' credits as well. Thus, as modified by this single change, the 1958 example of an export subsidy was: "The government *bearing all or part of the costs* incurred by exporters [or financial institutions] in obtaining credits."

78. The Panel should ask itself, if this language appeared, as it is, without any qualification, in Annex I to the SCM Agreement, would it apply to PROEX III? In Brazil's view, there can be little doubt that it would. With PROEX III, the Government of Brazil, in making PROEX payments, *bears all or part of the costs* incurred by exporters or financial institutions in obtaining credit. If this were all that was encompassed by the first paragraph of item (k), PROEX III would be prohibited.

79. But item (k) says more. It says, "in so far as they are used to secure a material advantage in the field of export credit terms." When this language is given full and complete effect by an *a contrario* interpretation, it leaves unresolved only the third point that Brazil must establish: material advantage.

80. In its August 1999 Report, at paragraph 181, the Appellate Body concluded that interest rates at or above the CIRR do not confer a material advantage. In paragraph 6.87 of its May 2000 Report in the original Article 21.5 Review, the Panel found that the Appellate Body did not intend to duplicate, in the first paragraph, all of the elements that were necessary to secure the safe haven of the second paragraph. PROEX III employs the CIRR as a floor, a floor that may be elevated, as necessary, to be compatible with the international market. Thus, under the test established by the Appellate Body and the Article 21.5 Panel, PROEX III is not used to secure a material advantage.

81. In fact, Mr. Chairman, PROEX III does more than the Appellate Body and the Article 21.5 Panel said was necessary to avoid conferring a material advantage because, on its face, PROEX III is limited not only by CIRR, but by the international market, and by 85 percent maximum financing and a 10-year limit.

#### IV. CONCLUSION

82. For all of these reasons, Mr. Chairman, Brazil asks that the Panel find and determine that:

- (a) Canada has not carried its burden of establishing that PROEX III is a subsidy within the meaning of Article 1 of the SCM Agreement;
- (b) With PROEX III, Brazil in practice applies the interest rates provisions of the 1992 version of the *OECD Arrangement*, the version of the *Arrangement* incorporated by reference into the second paragraph of item (k) of Annex I of the Agreement;
- (c) With PROEX III, Brazil in practice also applies the interest rates provisions of the 1998 version of the *Arrangement*;
- (d) PROEX III is not used to secure a material advantage in the field of export credit terms.

83. This concludes Brazil's oral presentation, Mr. Chairman. We will do our best to answer any questions you may have.

**ANNEX B-4**

**CLOSING STATEMENT OF BRAZIL**

(5 April 2001)

1. [Minister Patriota] Good afternoon, Mr. Chairman. I would like to thank the Panel for the opportunity to present these closing remarks this afternoon. There are just two points I would like to make before asking my colleague Mr. Azevedo to address some additional points.

2. Mr. Chairman, it was a difficult job to change PROEX III. As you heard this morning from Mr. Azevedo, who was at the meetings in Brasilia and was involved in the process, there was opposition in Brazil to making the changes. Indeed, I would go so far as to say that there was bitterness and anger in some quarters. Some people did not want to make the necessary changes in response to the previous findings. Nevertheless, we got the job done and what you have before you is PROEX III. This is what you must review.

3. I would also like to address an issue that is very important to Brazil. This is the issue of what version of the *OECD Arrangement* applies. We believe that the Panel should apply the 1992 version instead of the 1998 version. As we explained in our oral statement, we do not think that the Panel should prefer an interpretation of the SCM Agreement that would give a small number of members of the OECD the perpetual power to change the rules for the remaining Members of the WTO. The Panel should not follow an interpretation that would lead to such an unfair result. You know our views on this, and I would sum up by simply repeating a sentence from paragraph 47 of our oral statement yesterday: there is nothing in the text of item (k) that unequivocally specifies that WTO Members have given a few countries the right to perpetually legislate on behalf of the overwhelming majority of the membership. This is of particular concern if we are to bear in mind that these few countries would be acting within the framework of an organization, the OECD, which is not open to universal accession.

4. I would now ask Mr. Azevedo to make the remainder of Brazil's points.

5. [Counselor Azevedo] Thank you. I would first like to address an issue that we have not previously talked about but which I think is important. It arises out of one of the questions posed by the Panel, which is based on an apparent assumption that the second paragraph of item (k) is an exception to the first paragraph of item (k). We are not sure whether the question intended to give meaning to such an assumption, but we think it is important that we clarify that we do not agree with the assumption.

6. The second paragraph of item (k) is separate from the first paragraph, which ends with a full stop. Thus, while the second paragraph begins "Provided that, however," it is a separate sentence from the first paragraph. Also, the first and the second paragraph talk about two different things. The first paragraph talks about one form of direct financing and about "payments" of the costs of obtaining export credits. As we have seen, there is much discussion about what this means. Regardless of what this means, however, the second paragraph talks about something different. It talks about "export credit practices." This is a much broader category than the specific items included in the first paragraph. For this reason, the second paragraph cannot simply be seen as an exception to the first paragraph. It has a broader scope than the first paragraph.

7. I would also like to address another important point that we have not discussed that was raised by the EC in its oral statement this morning. This is the definition of "export credits." The EC claimed in paragraph 26 of its oral statement that PROEX III interest rate support does not fit the

definition of export credits. But the EC's statement just stops there. The EC does not give any reason why PROEX III does not fit the definition.

8. PROEX III is a form of interest rate support, which is a form of export credits. The *OECD Arrangement* does not define "interest rate support." In fact, it says that the Participants themselves do not agree on the definition of the term. We have tried to find out what they mean by the term. I called Ms. West at the OECD and got no answer as to the meaning of the term. We sent cables to our embassies in all of the OECD members countries asking them to try to find out how each member interpreted the term. No one could tell us the answer. Some referred to internet sites or public documents that were unhelpful since they did not explain how the countries' mechanisms worked in practice. Some other members did not even want to talk about what it meant.

9. Anyway, Mr. Chairman, PROEX III payments support the interest rate for a given transaction. They are clearly interest rate support within any reasonable definition of the term.

10. Mr. Chairman, one issue that arose this morning – a question that the Panel asked and Brazil answered – is worth emphasizing again. It is this: The rules of PROEX III are clear and unambiguous. Interest rates support can be provided for up to 85 percent of the value of the contract, for a period no longer than 10 years and at a rate no lower than the applicable CIRR. The Committee administering PROEX III is permitted to depart from those rules only in cases where the Committee is satisfied that the terms of interest rates support provided under PROEX III are terms that are compatible with the terms available in the international market. The applicant requesting interest rates support will have to persuade the Committee that the terms requested are terms that are consistent with the international market. If the applicant fails to persuade the Committee, if the Committee is not satisfied that the terms requested comply with that requirement, the Committee will have no authority to use the exception and to approve the application on terms different from those provided in the general rules. The Committee members are subject to review by the Brazilian government's *Tribunal de Contas da União*, which is responsible for ensuring that Brazilian government agencies do not spend public monies except in accordance with law.

11. I am not in a position today to say exactly what the Committee will look at, exactly how this determination will be made, but I can clearly state that this is the standard. In sum, the Committee, operating under PROEX III will either operate under the safe haven of the second paragraph of item (k) or, when providing terms of interest rates support consistent with the market under the exception, will confer no "benefit."

12. Mr. Chairman, Canada has admitted that it bears the burden of proof to show that Brazil is in breach of its obligations under the SCM Agreement. Further, Canada has admitted that the issue before this Panel is PROEX III, *i.e.*, whether PROEX III is in conformity with the provisions of the SCM Agreement. To meet its burden of proof, Canada has submitted only press reports and affidavits about what Embraer sales persons allegedly offered in the context of a transaction that did not take place. By contrast, Brazil has submitted all of the documents that, taken together, constitute PROEX III. It is the review of these documents that, in our view, is the primary task of the Panel because, again – as Canada has itself admitted – the issue before the Panel is the conformity of PROEX III to the SCM Agreement. The evidence that the Panel has is, on the one hand, PROEX III, submitted by Brazil, and, on the other hand, press reports, submitted by Canada. It is up to the Panel to evaluate the evidence on the merits and decide what is the weight and significance of the evidence submitted by each of the Parties. It is the view of Brazil, however, that no press report can rebut the provisions of PROEX III, the very programme that this Panel must examine and evaluate.

13. I also would like to point out again that Brazil denies that any PROEX III assistance was offered by Brazil under the terms alleged by Canada through the "evidence" Canada submitted: the claims of sales persons and the press reports. In addition, once again, I would like to note that, even if some of the hearsay evidence submitted by Canada were true, Brazil is not responsible for what a

sales person might offer to a customer. Brazil is only responsible for interest rates support approved under PROEX III. A sales person might offer terms that would not be subsequently approved by the Committee. An offer in itself, even if such an offer were made by a sales person, is not in itself evidence of breach of Brazil's obligations under the SCM Agreement.

14. In conclusion, Mr. Chairman, Brazil would like once again to emphasize that PROEX III conforms to Brazil's WTO obligations. PROEX III confers no benefit and, therefore, is not a subsidy. Alternatively, through PROEX III, Brazil in practice applies the interest rates provisions of the *OECD Arrangement* and, therefore, PROEX III is covered by the safe haven of the second paragraph of item (k) of the Illustrative List. Finally, in case the Panel disagrees with both of these arguments, PROEX III is a payment under the first paragraph of item (k) which is not used to provide material advantage and, consequently, is not a prohibited subsidy.

ANNEX B-5

RESPONSES BY BRAZIL TO QUESTIONS  
OF THE PANEL AND CANADA

(17 April 2001)

For Brazil

**Q1. Please address whether, compared to the PROEX programme under consideration in the first Article 21.5 proceedings, the legal framework of the PROEX programme has undergone any revision other than that effectuated through BCB Resolution 2799, in so far as it relates to financing the export of regional aircraft. If so, please submit relevant evidence.**

BCB Resolution 002799 makes significant changes to PROEX III. One of the most important changes is the requirement that interest rate support should not bring the interest rate below the CIRR. This requirement, coupled with the previous amendment, reflected in Circular-Letter 002881, that the maximum percentage of interest rate support shall not exceed 2.5 percent, may in fact often produce a result where, after the interest rate support is provided, the resulting interest rate is still above the CIRR. Moreover, the Resolution specifically allows the Committee on Export Credits to establish the terms of interest rate equalization for exports of regional aircraft on a case-by-case basis, at levels that may vary according to the specifics of each transaction, but always in compliance with the CIRR. Thus, BCB Resolution 002799 does not require that the resulting interest rate shall be always at the CIRR; instead, it sets the CIRR as the floor and anticipates that interest rate equalization will be provided at or above the level of the CIRR.

Another important change introduced by Resolution 002799 (Article 8, para. 2) is the requirement that the Committee shall use "as reference the financing terms practiced in the international market" when "analyzing received requests for eligibility." This provision has a twofold effect. On the one hand, it requires the Committee to use the terms practiced in the international market as an additional criterion even when all the other eligibility criteria are met. In other words, when the Committee evaluates requests for interest rate equalization, it must use the market as a reference, in addition to the specific eligibility criteria of PROEX III. On the other hand, this provision allows the Committee to provide interest rate support on terms that may depart from the specific eligibility requirements of PROEX III provided, however, that those terms are consistent with the terms practiced in the international market.

These new requirements, introduced by Resolution 002799, together with the previously existing requirements bring PROEX III in compliance with Brazil's obligations under the SCM Agreement.

**Q2. In the original dispute, Brazil stated in respect of PROEX I that "PROEX presumably would always be more favorable to the purchaser than the terms it could obtain on its own; otherwise, the purchaser would have no interest in PROEX" (Panel Report on *Brazil – Aircraft* (WT/DS46/R), para 7.35). Does Brazil contest that payments under PROEX III allow a purchaser of regional aircraft to obtain financing for Embraer regional aircraft on terms more favourable than those otherwise available to that purchaser in respect of the particular transaction in the commercial marketplace? If so, please explain in what relevant respect PROEX III differs from PROEX I.**

As questions 2 and 3 for Brazil raise similar issues, Brazil will answer the two questions together. It is important to understand how PROEX III works in the context of a transaction as a whole. The conclusion of the Article 21.5 Panel quoted in question 3 to the effect that under

PROEX II "a borrower negotiates the best interest rate it can obtain in international financial markets, and then benefits from a buy down of that interest rate" does not accurately reflect the process, particularly with respect to PROEX III. The process of negotiating a sale and obtaining PROEX support is not a linear process, and does not result in a commercially-negotiated interest rate that is then further reduced by PROEX support. Put another way, the parties do not negotiate a commercial rate and then use that as the starting point in applying for PROEX support, which, if granted, would *further* reduce the commercially negotiated rate.

To the contrary, the negotiations are a complex process that involve several parties – including at a minimum the seller, the lender, and the buyer. There may be equity investors, guarantors, insurers and other parties also involved in the transaction. Frequently, the buyer also may be negotiating with several potential sellers and other lenders. These negotiations are controlled by the prevailing commercial rates in the market place. However, the possibility of PROEX involvement in the transaction does not reduce the net interest rate below what would otherwise be available in the marketplace; it simply places the rates available to purchasers of Brazilian aircraft at the same level as rates available for other regional jet aircraft from other vendors with their financial institutions.

This may arise in three situations. In the first, a buyer – assume a Chinese buyer – may be quoted an interest rate of eight percent (assume this is at/above the CIRR) by an international financial institution, such as Chase Manhattan or Citibank, to purchase Brazilian aircraft. A Brazilian bank may not be able to offer eight percent without PROEX support. In this case, PROEX may enable the Brazilian bank to provide the Chinese buyer the same terms as are available for that transaction in the international marketplace (*i.e.*, Chase Manhattan or Citibank) but with the added convenience of dealing with a bank with whom the seller is familiar, and a bank that is more familiar with transactions of that kind. In financial terms, however, PROEX would not place the buyer in any better situation or give it any better terms for the transaction than are available in the international marketplace.

In the second situation, the Chinese buyer may be offered eight percent terms by an international financial institution (again, assume this is at/above the CIRR) to finance a purchase of Brazilian aircraft. The Chinese buyer, however, would prefer to finance the transaction through a Chinese bank. The Chinese bank, however, is able to offer credit only at 10 percent. In this case, PROEX support may enable the Chinese bank to provide credit at eight percent and thereby facilitate the buyer's preference for its own bank. Again, however, PROEX would not place the buyer in any better situation or give it any better terms for the transaction than are available in the international marketplace.

In the third situation, assume that an airline is quoted a rate of eight percent for a purchase of regional aircraft by an international financial institution (assume also that this rate is at the CIRR). Brazil's manufacturer, Embraer, may want to compete for the sale and offer the same financing package. However, a Brazilian bank may not be able to provide financing at eight percent because of its higher cost of dollars, but rather might quote a rate of nine percent. In those circumstances, Embraer may apply for PROEX support to enable it to offer financing at the eight percent rate. Again, this would enable Embraer to offer terms that are equal to, though not more favourable than, the terms that are available to the borrower in the international marketplace.

Accordingly, in each of these three situations, the first Article 21.5 Panel's conclusion that PROEX reduces a previously-negotiated rate below the commercial rate does not reflect how the market operates and how PROEX becomes involved in transactions.

Brazil's statement that PROEX would always "be more favorable to the purchaser than the terms it could obtain on its own, otherwise the purchaser would have no interest in PROEX" must be read in the context of the examples given above. If PROEX were not involved in the transaction, the purchaser would be offered a financing package at 9 percent by the Brazilian bank. In that case, the

purchaser would likely take the financing package offered by the competitor rather than the PROEX-supported package. However, the PROEX-support would still not result in a net interest rate that is lower than either the CIRR or the terms that might otherwise be available in the marketplace.

Thus, Brazil does indeed contest that PROEX III payments would allow a purchaser to "obtain financing on terms more favorable than those otherwise available to *that purchaser* in respect of the *particular transaction* in the *commercial marketplace*." While PROEX III payments may allow the purchaser a broader range of financing options, the rates offered with PROEX support would *not* allow the purchaser to obtain regional aircraft at terms more favorable than would be available through other financial institutions in the commercial marketplace. The requirement that the minimum interest rate must be the CIRR, of course, reinforces this fact.

These questions go to the issue of whether, as Canada claims, PROEX III confers a benefit in every case. For the reasons explained above, PROEX III does not reduce the interest rate below the commercial market rates. Rather, it enables Brazil's manufacturer and financing institutions to participate in the transaction at the market rates. Brazil notes in this regard that the Appellate Body framed the issue as whether PROEX reduced the *net* interest rate below the CIRR or other appropriate market benchmark. The Appellate Body thereby implicitly rejected the presumption that PROEX always and necessarily reduced the net interest rate below the market rates.

With respect to the final sentence of question 3, as explained above, Brazil contests the accuracy of the first Article 21.5 panel's description of the process for both PROEX I and PROEX III. While the panel's description may have sufficed as a shorthand description of the process, when the process itself was not the issue, it did not accurately reflect the complexity of these transactions. That said, there are nevertheless significant differences between PROEX III and previous iterations of the programme. First, PROEX III requires a minimum interest rate of the CIRR for all PROEX-supported transactions. This is the floor rate that the Appellate Body, and, indeed, Canada, have previously said that PROEX must apply. In contrast, PROEX I had no requirement of any minimum interest rate. Similarly, the minimum interest rate under PROEX II (T-bill plus 20 basis points) was below the CIRR. Moreover, PROEX III requires that the Committee on Export Credits must follow the rates prevailing in the market place in deciding whether to approve PROEX III support. This requirement was not present in either PROEX I or PROEX II.

Finally, even if PROEX III did bring the interest rate below the commercial rate in particular instances, the fact that PROEX III applies the interest rates provisions of the *OECD Arrangement* means that it is eligible for the safe haven of the second paragraph of item (k).

**Q3. In the first Article 21.5 proceedings, the Panel found that, under PROEX II, "... a borrower negotiates the best interest rate it can obtain in international financial markets, and then benefits from a buy down of that interest rate..." (Article 21.5 Panel Report on *Brazil – Aircraft*, para. 6.89). In its oral statement to the Panel (para. 7), Brazil appears to contest that this is the case in respect of PROEX III. If this is correct, in what relevant respect does PROEX III differ from PROEX I and II?**

Please refer to the response to question 2 above. Because of the similarity of the issues raised by questions 2 and 3, Brazil has provided a single response to the two questions.

**Q4. Is Brazil through its benefit arguments suggesting that in some cases financial institutions receiving PROEX III payments receive the payments without in any way improving the terms and conditions of the financing in respect of which PROEX III payments are made, i.e., that PROEX III payments are in some cases exclusively a subsidy to a financial institution? If so, and given that PROEX III payments may be provided where financing is provided by non-Brazilian banks, is Brazil suggesting that PROEX III is a subsidy for foreign banks?**

As explained in the answer to question 2 above, PROEX III payments would enable Embraer to provide a net interest rate at the rates prevailing in the market place. This does not enable the seller to provide financing at terms more favorable than are otherwise available in the marketplace. However, it must be borne in mind that in the international aviation market, it is important that manufacturers are in a position to offer competitive financing at prevailing market rates. No aircraft manufacturer in the world tells airlines, "This is the price. Pay cash, or go borrow the cash from a bank." It is the custom in the trade, established long before Brazil began producing aircraft, for the manufacturers to have available a financing package for their sales, and these packages generally include some form of official government support for export credits.

Other manufacturers in other countries all have export credit support available – Canada through EDC, the United States through Eximbank. PROEX payments enable Embraer to avoid a competitive disadvantage in the marketplace by enabling it to offer financing at the CIRR and market rates. To the extent that PROEX III results in one bank rather than another providing the financing for a particular transaction, then it is the case that the bank profits or benefits from the PROEX support. This applies even where the bank is not a Brazilian bank, but is in another country, particularly a developing country. PROEX III support enables that bank to participate *at international market rates* in a financing transaction in which it would not otherwise be able to participate.

**Q5. Is the Committee on Export Credits required to approve operations meeting the eligibility criteria set forth in BCB Resolution 2799 and Directive 374 and the National Treasury thus required to provide equalisation (i.e. is there a conditional entitlement to PROEX III support)? Or does the Committee retain discretion regarding whether or not PROEX III support is provided even where the eligibility criteria are met?**

The Committee on Export Credits is not required to approve interest rate support financing even in the case of transactions where all the eligibility criteria provided by PROEX III are met. There is nothing in PROEX III that imposes on the Committee an obligation automatically to approve the granting of interest rate support once the Committee establishes that the eligibility criteria of PROEX III are met. The Committee thus retains discretion regarding whether or not PROEX III support is provided.

Article 1 of BCB Resolution 002799, for example, states that " ... the National Treasury *may* provide to the financing or re-financing agency, as the case may be, equalization enough to render financing costs compatible with those practiced in the international market." (Emphasis ours.) Further, Article 2 of Resolution 002799 states: "Equalization *may* be granted when financing the importer, for cash payments to the exporter established in Brazil, as well as when re-financing granted to the latter." Resolution 002799 therefore imposes no obligation on the Committee to provide interest rate support even when all the eligibility criteria are met. The Committee must comply with certain mandatory requirements (e.g., the CIRR, 85 percent of the value of the sale, 10 year period of financing) but retains the authority – subject to the terms of the international marketplace – to determine the specific terms of the interest rate support "on a case by case basis, at levels that may vary according to the characteristics of each operation" as provided in Article 1, para. 1 of Resolution 002799.

**Q6. Is there a requirement, under Brazilian internal law, for the executive branch of the government to interpret provisions of internal law and exercise discretion conferred on it under internal law in such a way as to conform to Brazil's WTO obligations? If so, please explain and submit evidence.**

The Congress of Brazil has the power to ratify treaties signed by the Executive. When the Congress does so, it normally adopts legislation incorporating the treaty's text into Brazilian law. However, treaties may not have direct effect in Brazil unless, in addition to the legislation incorporating the treaty, the Executive also issues regulations giving internal effect to the treaty. The WTO Agreements have been incorporated and implemented into the domestic law of Brazil in this manner.

Because Brazil's WTO obligations have been implemented and have become part of Brazil's domestic law, the executive branch must comply with those obligations as it does in the case of any other obligations imposed on it by any other provision of Brazil's domestic law. If other provisions of Brazil's domestic law *allow* the Executive to act in a way that may be inconsistent with its WTO obligations, the potential conflict would be resolved in favor of consistency with Brazil's WTO obligations. The Executive, even if permitted to act in a manner inconsistent with the WTO by other provisions of Brazil's domestic law, would still *have the duty* under domestic law to comply with its WTO obligations because the WTO Agreements have been implemented in Brazil's domestic law. The only situation where a conflict would arise is if another provision of Brazil's domestic law *requires* the Executive to act in a manner inconsistent with Brazil's WTO obligations. In such a case, there would be a conflict between one provision of Brazil's domestic law and another provision of Brazil's domestic law. This is *not* the case with PROEX III. There is nothing in PROEX III that *requires* Brazil's executive branch to act in a manner inconsistent with Brazil's WTO obligations. In applying PROEX III, the executive branch remains bound by Brazil's WTO obligations as implemented in Brazil's domestic law.

**Q7. In the *Canada – Aircraft* Article 21.5 panel proceedings (Article 21.5 Panel Report on *Canada – Aircraft*, Annex 1-2, para. 62, p. 75), Brazil argued that "Canada's 'Policy Guideline' merely suggests that prohibited export subsidies *via* Canada Account *might not* be granted; as noted above, to be sufficient, an implementation measure must instead *ensure* that prohibited subsidies *cannot* be granted." Should the same standard apply to Brazil in the context of Brazil's item (k) second paragraph defence in these proceedings? If not, why not?**

In the *Canada – Aircraft* Article 21.5 Panel proceedings, Brazil argued that the standard referred to in the question should apply to the implementation measures announced by Canada with respect to Canada Account because Canada Account was found by the original Panel to be inconsistent with Canada's WTO obligations not only *de jure*, but also *as applied*. In the Article 21.5 proceedings, Canada argued that it had implemented the recommendations and rulings of the DSB because: (i) no new transactions had been financed through Canada Account; and (ii) it adopted a "Policy Guideline" stating that the Minister of International Trade would, as a policy matter, not approve transactions that are not in compliance with all of the provisions of the *OECD Arrangement*.<sup>1</sup> Canada argued that because Canada Account was found inconsistent *as applied*, Canada had no obligation and bore no burden to demonstrate how it complies with the second paragraph of item (k) unless, at some time "in the future, there is a financing transaction under Canada Account in relation to which Canada claims the exception in Item (k) and the claim to that exception is challenged."<sup>2</sup> Further, Canada argued that the "Policy Guideline" stated an intention to "meet the criteria to qualify for an exception under the second paragraph of Item (k)."<sup>3</sup>

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<sup>1</sup> See *Canada – Measures Affecting the Export of Civilian Aircraft*, Recourse by Brazil to Article 21.5 of the DSU, WT/DS70/RW, 9 May 2000, paras. 5.57-5.58 ("Article 21.5 Panel Report").

<sup>2</sup> *Id.*, Annex 2-1 (Canadian First Submission), para. 67.

<sup>3</sup> *Id.*, para. 68.

Brazil responded to these arguments by pointing out that what Canada had done was insufficient. First, Brazil argued that Canada could not simply state that it had brought Canada Account in compliance only because there had been no new transactions. Second, Brazil argued that the "Policy Guideline" referred neither to the "interest rates provisions" of the *OECD Arrangement* nor to conformity with the second paragraph of item (k). It only stated an intention to comply with the *Arrangement* in its entirety, without any indication of the specific provisions with which it intended to comply.<sup>4</sup> Brazil suggested that Canada should specify how it intended to comply with the interest rates provisions of the *Arrangement* and the particular interest rates provisions of the *Arrangement* with which it intended to comply.<sup>5</sup> Brazil suggested that "[t]he minimum burden accorded to Canada must be to explain with some precision what 'comply with the OECD Arrangement' will mean."<sup>6</sup> Instead, Canada issued a one sentence "Policy Guideline" that merely suggested that under Canada Account prohibited export subsidies might not be granted. Under the Guideline, for example, Canada would have been free to utilize the "matching" provisions of the *Arrangement*. The Panel had found that these were not "interest rates provisions."<sup>7</sup>

PROEX III does considerably more than did Canada's implementation measures with respect to Canada Account and meets the standard proffered by Brazil, as described above. PROEX III is not a blanket statement that the programme complies with the *Arrangement*. PROEX III contains specific requirements that are consistent with the specific criteria set out in the interest rates and other relevant provisions of the *Arrangement* (e.g., the CIRR as a floor, financing up to 85 percent of the export value of a sale, financing for a period of up to 10 years). PROEX III imposes on the Committee specific eligibility criteria that meet or exceed the disciplines contained in the interest rates provisions of the *Arrangement*. Therefore, PROEX III does ensure that financing under its terms qualifies for the safe haven of the second paragraph of item (k).

Brazil also notes that the Appellate Body in *Canada – Aircraft* Article 21.5 proceedings found that "the words 'ensure' and 'future,' if taken too literally, might be read to mean that the Panel was seeking a strict guarantee or absolute assurance" as to the future application of the revised programme. The Appellate Body concluded that "[a] standard ..., if so read, would ... be very difficult, if not impossible, to satisfy since no one can predict how unknown administrators would apply, in the unknowable future, even the most conscientiously crafted compliance measure."<sup>8</sup> Brazil can thus do no more than adopt an implementation measure that specifically addresses the way in which it will, as a matter of law, comply with its WTO obligations – which is exactly what PROEX III does.

**Q8. Brazil argues that "the maximum percentage allowed under PROEX III for the purpose of interest rate equalisation is 85 per cent of the export value of the sale" (Brazil's first submission, para. 43). Is it Brazil's position that PROEX III would not allow Brazil to exceed this maximum percentage in respect of regional aircraft? If so, why? When responding to this question, please specifically address:**

- (a) **Article 5 of Directive 374;**
- (b) **Article 8 of Directive 374;**

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<sup>4</sup> *Id.*, Annex 1-2 (Brazil Rebuttal Submission), para. 69.

<sup>5</sup> *Id.*, para. 72.

<sup>6</sup> *Id.*, para. 76.

<sup>7</sup> *Id.*, paras. 5.125, 5.126, 5.132-5.134, and 5.147(d) and (f).

<sup>8</sup> *Canada – Measures Affecting the Export of Civilian Aircraft*, Recourse by Brazil to Article 21.5 of the DSU, Report of the Appellate Body, WT/DS70/AB/RW, 21 July 2000, para. 38.

(c) **the statements reported by Canada in paragraph 11 of its first written submission and paragraphs 20-26 of its rebuttal submission.**

(a) Brazil's position is indeed that PROEX III would not allow Brazil to exceed the maximum percentage for the purpose of interest rate equalization – 85 percent of the export value of the sale – with one possible exception. The rule is contained in Article 5 of Directive 374. Article 5 of Directive 374 prohibits interest rate equalization for more than 85 percent of the export value of the sale. The exception is contained in Article 8, para. 2 of BCB Resolution 002799, which allows departure from the specific eligibility criteria in PROEX III only when interest rate support is provided on terms consistent with the international market. Thus, if the Committee is satisfied by the applicant and its own research that interest rate equalization based on more than 85 percent of the export value of the sale would nonetheless be consistent with the terms prevailing in the international market, the Committee could (but would have no obligation to) provide interest rate support on the same terms as those available in the international market. In that instance, PROEX III would not confer a benefit, since it would provide support consistent with that available to the recipient in the market.

(b) Article 8 of Directive 374 does not allow Brazil to exceed the maximum percentage of 85 percent of the export value of the sale. This Article actually applies to requests of PROEX support that concern products that are not included in the Annex, or whose commercialisation in the international market require terms that exceed those set out in the programme. For example, the repayment term practiced in the international market could exceed the one stipulated in the Annex for that particular product. Article 8 ensures that the Secretaria de Comércio Exterior (SECEX) is aware of such situations with a view to reassess the operation of the programme in light of these circumstances. SECEX has no authority to approve the requests that do not conform to the basic guidelines of the programme. Such authority is vested on the Comitê de Crédito às Exportações, as established in Article 8 (c) of Banco Central Resolution 2799.

(c) Canada ignores the very text of the documents that constitute PROEX III and submits instead "evidence" that is based on newspaper articles and reports. In paragraph 11 of its first written submission, Canada refers to a newspaper report of a statement by then-Foreign Minister Lampreia. First, there is no guarantee that the newspaper accurately reported what Minister Lampreia actually said. Second, even if accurate, the statement was made *before* PROEX III was approved and adopted. Third, again even if accurate, the statement expresses the view of a Brazilian official who may or may not have approved of the proposed revisions of PROEX. Moreover, Minister Lampreia's Ministry is not involved in administering PROEX. Finally, whatever Minister Lampreia's views might have been at the time, PROEX III subsequently was approved and enacted. The relevant documents have been submitted to this Panel. This programme, rather than the Minister's statement, is before the Panel.

In paragraphs 20 through 26 of its rebuttal submission, Canada similarly uses newspaper reports that may or may not accurately reflect the statements made by Brazilian officials. For example, the statement by Ambassador Graça Lima, as reported, may be interpreted in different ways. Even if reported correctly, the statement in fact contains nothing objectionable from Canada's perspective because even before December 2000, PROEX required terms of financing of up to 10 years and up to 85 percent of the export value of the sale, and those terms in themselves do not depart from Brazil's WTO obligations. In addition, this statement also was made prior to adopting and enacting PROEX III. The other two press reports referred to in paragraphs 23 and 24 of Canada's rebuttal submission do not even cite names of Brazilian officials. They either express the views of the newspaper or the reporter or cite anonymous "Brazilian authorities."

Brazil does not suggest that newspaper articles and reported statements by government officials should *ab initio* be discarded without assessing their evidentiary value. In some cases, there may be no other evidence available. In this case, however, the newspaper articles (even assuming everything they report is accurate) provide at best evidence of the divergence of views in the Brazilian

Government about revising PROEX and of some public comments about Brazil's negotiations with Canada. They do not provide evidence of what PROEX III *actually requires*. This evidence is provided by the documents constituting PROEX III. Brazil has submitted those documents to the Panel. There is no better evidence about what PROEX III is and what PROEX III requires than the evidence contained in the PROEX III documents themselves.

Finally, Canada grossly misstates and misinterprets the positions and views expressed by Brazil during their negotiations. Canada states that Brazil publicly insisted that it would not abide by the provisions of the *OECD Arrangement* and that, during the negotiations, Brazil refused to consider adjusting PROEX to the interest rates provisions of the *Arrangement*. Canada ignores the fact that Brazil consistently has adhered to the view that the second paragraph of item (k) does not require compliance with *all* of the provisions of the *Arrangement*. In addition, Canada omits to note that Canada and Brazil disagree on what are the interest rates provisions of the *Arrangement*. With those points in mind, Brazil's position is clear and consistent: Brazil has pledged to comply with the CIRR and has established the CIRR as a floor, complies with those provisions of the *Arrangement* that Brazil believes are the interest rates provisions, and does not believe it has an obligation to comply with the other provisions of the *Arrangement*.

**Q9. Brazil argues that "the maximum length of the financing term under PROEX III is ten years" (Brazil's first submission, para. 48). Is it Brazil's position that PROEX III would not allow Brazil to exceed this maximum financing term in respect of regional aircraft? If so, why? When responding to this question, please specifically address:**

- (a) **Article 3, paragraphs 1 and 2, of Directive 374;**
- (b) **the statements reported by Canada in paragraph 11 of its first written submission and paragraphs 20-26 of its rebuttal submission;**
- (c) **your statement in the first *Brazil - Aircraft* Article 21.5 proceedings that, under PROEX I and II, the ten-year maximum "was waived, and continues to be waived, for regional jet aircraft only" (Article 21.5 Panel Report on *Brazil - Aircraft*, Annex 2-4, question 6, p. 135). In this regard, does Brazil contend that the legal provisions allowing such a waiver no longer exist? If they still exist, (i) which are they and (ii) what is the basis for Brazil's assertion that the maximum length of the financing term under PROEX III is ten years?**

(a) Brazil's position is indeed that PROEX III – and in particular Directive 374 – would not allow Brazil to exceed the maximum period of 10 years for the purpose of interest rate equalization. The only possible exception is contained in Article 8, paragraph 2 of BCB Resolution 002799 which allows departure from the specific eligibility criteria in PROEX III only when interest rate support is provided on terms consistent with the international market. Thus, presumably, if the Committee is satisfied by the applicant and its own research that interest rate equalization is provided in the international market for a period longer than 10 years, the Committee could (but would have no obligation to) provide interest rate support on the same terms as those available in the international market. In that instance, PROEX III would not confer a benefit, since it would provide support consistent with that available to the recipient in the market.

Article 3.1.I of Directive 374 simply ensures that the equalization payments will not exceed the financing term of the contract signed by the exporter, even if it is shorter than the term allowed in the Annex. Article 3.1.II limits the repayment term to that indicated in the Annex, except as provided in paragraph 2 of the same Article and Article 4.

Article 3.2 indicates that the repayment terms indicated in the Annex may be extended up to 96 months if warranted by the unit values, as indicated in the table reproduced in that paragraph. This

provision obviously applies to products with repayment terms under 96 months in the Annex. This is not the case for regional aircraft.

Article 4 deals with exports that involve more than one product and the application of the methodologies set out in items (a), (b), and paragraph 1 could not mathematically result in repayment terms longer than the 10 year maximum.

(b) See response to Question 8(c) above.

(c) The basis for Brazil's assertion that the maximum length of the financing term is 10 years is the specific requirement to that effect in Directive 374, and the requirement of Article 1.1 of BCB Resolution 002799 that interest rate equalization must be provided in compliance with the CIRR. As explained in (a) above, the possibility for a waiver does exist. It is provided in Article 8, para. 2 of BCB Resolution 002799 which allows departure from the specific eligibility criteria in PROEX III but only when interest rate support is provided on terms consistent with the international market. Thus, the waiver is permissible only when the Committee is satisfied by the applicant and its own research that interest rate equalization is provided in the international market for a period longer than 10 years. In such a case, the Committee could (but would have no obligation to) provide interest rate support on the same terms as those available in the international market. Thus, if the length of the term of financing available in the international financial market exceeds 10 years, the Committee would have the discretion to apply the same length of the term of financing. Again, in that instance, PROEX III would not confer a benefit, since it would provide support consistent with that available to the recipient in the market.

**Q10. Has Brazil issued any letters of commitment under PROEX III in respect of regional aircraft? If yes, did the transactions in question involve financing of greater than 10-years' duration and/or financing in excess of 85 per cent of the amount of the sale? Please provide supporting details with respect to each transaction.**

No, Brazil has not issued any letters of commitment under PROEX III in respect of regional aircraft.

**Q11. To the extent you have not done so, please address specifically whether and why PROEX III is "in conformity with" Articles 8, 9, 12-14, 16-26 of the 1998 OECD Arrangement as well as Articles 18-20, 23-24, 27-28, 29(b) and (c) of Annex III to the 1998 OECD Arrangement. Please substantiate your view.**

Brazil notes that in its view, the provisions referred to above are not properly considered as interest rates provisions. Therefore, in order to qualify for the safe haven of the second paragraph of item (k), PROEX III should not be required to conform with each and every one of these provisions. Nevertheless, for the reasons explained below, Brazil submits that PROEX III does in fact conform to the provisions listed in the question.

Articles 8 and 9 of the *Arrangement* provide that the repayment term runs from the starting point of the credit, defined as the date on which the buyer takes possession of the goods in his own country, to the date of the final payment. PROEX III is in conformity with these requirements, in that Article 3 of Directive 374 stipulates that the payment term is the period from the date of shipment or *delivery* to the date of maturity of the last equalization payment. Since PROEX payments are normally made in 6-month increments over the term of the loan, this will coincide with the date of the last payment.

Article 12 (together with Article 10) of the *Arrangement* sets out maximum repayment terms for categories of countries. These provisions are superseded by the provisions of Article 21 of the Annex to the *Arrangement*, which establishes a maximum repayment term of 10 years for regional jet

aircraft. PROEX III is consistent with this in that the Annex to Directive 374 establishes a maximum repayment term of 10 years for regional jet aircraft.

Article 13 of the *Arrangement* calls for repayment of principle in regular instalments not less than six months in frequency. Similarly, Article 14 of the *Arrangement* calls for the payment of interest on a six-monthly basis. Article 4 of Resolution 2799 conforms with these requirements in that it provides for calculation of the amounts due for equalization purposes on a six-month basis and calls for the issuance of NTN-I bonds on a six-monthly basis.

Articles 16 and 17 govern the calculation of the CIRR. Resolution 2799 provides that the net interest rate for a PROEX-supported transaction may not be below the CIRR. Since Brazil is not a Participant in the *Arrangement*, however, Brazil does not play any role in calculating the CIRR and therefore PROEX III does not contain parallel provisions to Articles 16 and 17 governing how the CIRR is to be calculated.

Articles 18 through 24 of the *Arrangement* govern cosmetic interest rates and minimum premiums. These provisions do not apply to interest rate support and, therefore, are not relevant to PROEX III.

Article 25 of the *Arrangement* refers to local costs. PROEX does not provide for financing of such costs.

Article 26 governs validity periods for lines of credit. This also does not apply to interest rate support such as PROEX.

Article 18 of the Annex to the *Arrangement* states that Part 2 of the Sector Understanding applies to aircraft other than large aircraft. The Article does not have any mandatory aspect. PROEX III may provide officially supported export credits for aircraft other than large aircraft and in that sense conforms with the Article.

Article 19 of the Annex imposes a hortatory burden on Participants to use best endeavours to respect the terms of the *Arrangement*. Since PROEX III requires a minimum interest rate of the CIRR, PROEX III is in conformity with this article.

Article 20 of the Annex divides the aircraft subject to part two of the sector understanding into three categories, and must be read in conjunction with Article 21 establishing maximum repayment terms. As explained in Brazil's First Submission (paragraph 55), PROEX III conforms with these articles in that the regional jets at issue in this dispute are Category A aircraft, for which, in accordance with Article 21, PROEX III establishes a maximum repayment term of 10 years.

Article 23 of the Annex stipulates that the Participants shall not waive insurance premium or guarantee fees. Since PROEX does not involve guarantees, this provision does not apply.

Article 24 stipulates that the Participants shall not provide aid support. PROEX III does not contain provisions permitting aid support.

Articles 27 and 28 of the Annex provide that, for used aircraft, the credit terms shall not be more favorable than for new aircraft. Article 28 provides specific repayment terms for used aircraft. PROEX III does not contemplate the issue of used aircraft or the possibility of PROEX support for used aircraft sales, and Brazil is not aware that the Brazilian industry has made any sales of used aircraft. There have been no PROEX commitments made to support sales of used aircraft. Accordingly, these provisions are not relevant to PROEX.

Article 29 of the Annex provides for the financing of spare parts and engines. Brazil has stated its views on the applicability of Article 29(a) to PROEX in its First Submission (at paragraphs 59-61) and in its oral statement (at paragraphs 33-35). Articles 29(b) and (c) establish repayment terms of five years for spare engines and two years for other spare parts when not ordered with the new aircraft. Brazil notes that it does not manufacture engines and therefore does not sell engines separately from the aircraft. In any event, PROEX III conforms with these provisions to the extent that it establishes (in the Annex to Directive 374) that the maximum financing term for parts of aircraft shall be limited to five years (NCM Heading 8803) and one year (NCM Heading 8803.90). While the classification of goods is not entirely clear from the schedules, these classifications are consistent with – and indeed more stringent than – the requirements of Article 29 of the Annex to the *Arrangement*. Brazil notes again that spare parts financing has been a *de minimis* element of PROEX III support in the past and that spare parts financing has been provided only in connection with sales of new aircraft.

**Q12. With respect to Article 6 of Directive 374, what is the basis for Brazil's contention that this provision confers discretion on the Committee on Export Credits? (Brazil's first submission, para. 61) If the term "may" provides the basis for Brazil's contention, please also address the meaning of the term "may" in Article 2 of Directive 374.**

Article 6 permits applicants to include spare parts financing in their application for equalization support and grants the Committee discretion to approve equalization for spare parts financing. Article 2, in contrast, is a general provision regarding exports, which must be read as being limited by the maximum payment tenures referred to in Article 1 and listed in the Annex to Directive 374.

**Q13. With reference to Article 1, paragraph 1, of BCB Resolution 2799, please elaborate on the precise meaning of the phrase "interest rate equalisation shall be established on a case-by-case basis, at levels that may vary according to the characteristics of each operation". What are the characteristics at issue and how would they determine the level of interest rate equalisation?**

This phrase means that applications for PROEX III support will be considered on a case by case basis. While Resolution 2799 establishes a minimum net interest rate – the CIRR – and PROEX III support is limited to a maximum amount of 2.5 percent, the Committee is not required to approve a net interest rate as low as the CIRR in every case. In addition, the Committee is not required to approve 2.5 percent PROEX support in every case (and, in fact, may not do so where that would reduce the net interest rate below the CIRR). Thus, the question of whether to approve PROEX support and, if so, to what extent, must be determined based on the individual merits, or "characteristics," of each proposal.

**Q14. Regarding Brazil's reference to Article 8, paragraph 2, of BCB Resolution 2799, please answer the following questions:**

- (a) **What is the relevant "international market"? Is this a reference to the market for the product for which PROEX eligibility is requested?**

Because the international market for different products may vary, the term "international market" should be read as referring to the market in which the product for which PROEX support is requested competes.

- (b) **What is meant by the "financing terms"? Please give examples.**

The phrase "financing terms" should be interpreted as referring to all of the terms on which financing is offered. The terms may, of course, vary from transaction to transaction.

- (c) **What are the benchmark "financing terms"? (Those available to the borrower in question? The industry sector in question?)**

The financing terms in question refer to the terms that would be available for a comparable transaction for that buyer in the commercial marketplace. Please refer to the answer to question 2 above for further details.

- (d) **Do the financing "practices" referred to include officially supported financing?**

As explained previously, there is no accepted definition of "officially supported financing." Article 88 of the *OECD Arrangement*, for example, states that it was not possible for the Participants to agree on a definition of the term. Moreover, as indicated in Article 86 of the *Arrangement*, there is considerable debate as to whether so-called "market window operations" – where government export credit agencies purport to be purely commercial actors in the market – are properly considered as "officially supported financing."

Furthermore, there are many different types of officially supported financing, and it will not always be clear what, if any, official support is included in a transaction in the market place. To the extent that a transaction appears to conform with the marketplace, then that transaction would be deemed to be part of the "practices" that would be examined by the Committee.

- (e) **What is the meaning of the phrase "shall have as reference"? Does this language enable the Committee to approve financing of operations on terms more favourable than those prevailing in the international market at the relevant time?**

This phrase means the Committee must conform to the financing terms of the international market. The language prevents the Committee from approving financing on terms more favorable than those prevailing in the international market. Brazil notes, however, that there may be situations in which the CIRR is *below* the marketplace rates (Canada has previously explained that due to time lags in calculating the CIRR, the CIRR may be above or below the market at a given point in time)<sup>9</sup> In those circumstances, the Committee could provide PROEX support according to the interest rates provisions of the OECD Arrangement, and nevertheless benefit from the safe haven of the second paragraph of item (k).

- (f) **Specifically, how would the Committee determine the net interest rate for eligible operations involving the export of regional aircraft in situations where the financing terms practised in the international market "justified" repayment terms of, e.g., 15 years?**

The Committee would have to consider any proposal for financing that deviated from the CIRR based on the evidence placed before the Committee on a case-by-case basis. Brazil cannot comment on what that evidence may be for a future transaction. Brazil would note, however, that the CIRR may nevertheless be an appropriate rate for such a transaction, given that Canada has previously told the Panel that the terms in the marketplace may include interest rates below the CIRR (for Canada's "market window" financing) and loans with 15-18 year terms<sup>10</sup> In this instance, of course, the transaction would not be eligible for the safe haven of the second paragraph.

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<sup>9</sup> Brazil -- Export Financing Programme for Aircraft -- Recourse by Canada to Article 21.5 of the DSU, WT/DS46/RW para. 6.99 (9 May 2000).

<sup>10</sup> Article 21.5 Panel Report, page 81 (Canada's response to Question 2 posed by the Panel) and page 94 (Canada's response to Question 8 posed by Brazil).

- (g) **What is the relationship between Article 8, paragraph 2, and Article 1, paragraph 1? What of a case where reference to the financing terms practised in the international market would indicate an above-CIRR rate? Could the Committee still approve net interest rates at CIRR level?**

The CIRR is intended to be the floor, or minimum possible net rate that may be approved by the Committee. As explained above, where the market is above the CIRR, the Committee nevertheless may approve financing at a net interest rate equal to the CIRR and still qualify for the safe haven of the second paragraph of item (k).

- (h) **What is the relationship between Article 8, paragraph 2, and Directive 374? In particular, which would take precedence if the financing terms practised in the international market "justified" (i) repayment terms in excess of 10 years, (ii) loan-to-asset values in excess of 85 per cent?**

Article 8, paragraph 2 grants the Committee discretion to approve PROEX support so long as that support is consistent with the international market. Thus, the Committee would enjoy discretion under that paragraph to deviate from the terms of Directive 374. However, as discussed above, this discretion is not unlimited.

- (i) **With reference to para. 17 of Brazil's oral statement, please explain in what way Article 8, paragraph 2, of BCB Resolution 2799 adds to what is already stated in Article 1 thereof. In addition, does the reference to Article 8, paragraph 2, add anything to Article 2 of Provisional Measure 1629?**

Article 1 of Resolution 2799 establishes the general framework for equalization payments under the PROEX programme. Article 8, paragraph 2, imposes a specific affirmative requirement on the Committee to ensure that any PROEX support, in addition to meeting the specific criteria enumerated elsewhere, is consistent with the terms practised in the international markets. Thus, Article 8 paragraph 2, uses the mandatory verb "shall" in describing the Committee's obligations.

Article 2 of Provisional Measure 1629 deals with types of financing not covered by Article 1 of the same Provisional Measure. Article 1 refers to post-shipment PROEX operations. These are the only types of operations for which regulations have been issued and that PROEX currently supports. They could involve both direct financing and equalization payments. Resolution 2799 implements Provisional Measure 1629 with regard to equalization payments only. Article 8.2 of Resolution 2799 ensures that the financing terms practiced in the international market will be used as the reference by the Comitê de Crédito às Exportações, when approving equalization payments concerning post-shipment financing transactions that do not conform to the general rules of the programme.

Article 2 of Provisional Measure 1629 contemplated equalization payments for pre-shipment financing. This mechanism has never been implemented and PROEX has never made equalization payments under this mechanism.

**(Addressed to Both Parties)**

**Q21. On the assumption that the second paragraph of item (k) provides for an *exception* to the first paragraph thereof, would a Member invoking the second paragraph need to establish (i) that its internal law *allows* it to act in conformity with the interest rates provisions of the relevant OECD Arrangement or (ii) that its internal law *requires* it to act in conformity with the aforementioned interest rates provisions? If (ii) is correct, how does this view fit with the traditional distinction between mandatory and discretionary legislation in the GATT/WTO?**

As a preliminary matter, Brazil wants to emphasize that it disagrees with the assumption that the second paragraph of item (k) provides for an exception only to the first paragraph of item (k). Under the second paragraph of item (k) "an export credit practice" which is in conformity with the interest rates provisions of the *OECD Arrangement* "shall not be considered an export subsidy prohibited by" the SCA Agreement. If the second paragraph of item (k) provided for an exception from the first paragraph only, "an export credit practice" must be understood to cover only practices within the scope of the first paragraph. In other words, "an export credit practice" must either be a "grant by governments" or a "payment" within the meaning of the first paragraph of item (k). Nothing in the plain meaning of the text can be interpreted to mean or even suggest that "an export credit practice" under the second paragraph of item (k) (or, indeed, under the *OECD Arrangement*) should be construed so narrowly. An export credit practice is a concept that is much broader than the scope of the first paragraph of item (k). The assumption that the second paragraph of item (k) provides for an exception only to the first paragraph would require Members to show that their export practices are a "grant" or a "payment" as defined by the first paragraph of item (k) before they can claim the safe haven.

The safe haven is thus an exception from Article 3 of the SCM Agreement. A subsidy contingent on exports that would otherwise be a prohibited subsidy would not be in breach of the SCM Agreement if it qualifies for the safe haven of the second paragraph of item (k) regardless of whether it is a "grant" or a "payment" as defined by the first paragraph of item (k).

Whether the second paragraph of item (k) allows an exception from the first paragraph or from the SCM Agreement as a whole, PROEX III does not allow the relevant Brazilian authorities the discretion to act in breach of Brazil's obligations under the SCM Agreement. On the contrary, PROEX III requires conformity with the SCM Agreement: it requires that the Committee on Export Credits act in conformity with the specific disciplines of the interest rates provisions of the *OECD Arrangement* unless financing is provided on terms available in the market, in which case no benefit is conferred. Nevertheless, even assuming that PROEX III is discretionary and allows Brazil to act in a manner inconsistent with its obligations under the SCM Agreement, PROEX III cannot be challenged unless and until it is applied in such a manner.

Under the traditional GATT/WTO doctrine regarding the distinction between mandatory and discretionary legislation, "discretionary legislation" refers to legislation that gives the Executive the ability to apply a law either consistently or inconsistently with the country's treaty obligations<sup>11</sup> Under traditional GATT/WTO jurisprudence, "discretionary" legislation cannot be challenged until it is actually applied in a GATT/WTO-inconsistent manner.

In Brazil's view, the mandatory/discretionary doctrine has its roots in general or customary principles of international law. It derives both from a rule of construction (i.e., that two potentially conflicting provisions of law will be interpreted in such a way as to make them consistent) and a presumption (i.e., that the WTO Member will in fact apply its law in a WTO-consistent manner). As explained by the United States in *United States - Antidumping Act of 1916*, WT/DS136/R (31 March 2000) (challenge brought by the EC):

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<sup>11</sup> See, e.g., *United States - Measures Affecting Alcoholic and Malt Beverages*, DS23/R, adopted 19 June 1992, BISD 39S/206, para. 5.39 ("Recent panels addressing the issue of mandatory versus discretionary legislation in the context of both [GATT] Articles III:2 and III:4 concluded that legislation mandatorily requiring the executive authority to take action inconsistent with the General Agreement would be inconsistent with Article III, whether or not the legislation were being applied, whereas legislation merely giving the executive authority the possibility to act inconsistently with Article III would not, by itself, constitute a violation of that Article").

3.33 . . . the distinction in GATT 1947/WTO jurisprudence between discretionary and mandatory legislation is not based upon a particular provision of the WTO Agreement, nor is it limited in its application to a particular WTO provision . . . The distinction is a general principle developed by panels that most likely has its origin in the presumption against conflicts between national and international laws. It is both general international practice and that of the United States that statutory language is to be interpreted so as to avoid conflicts with international obligations. There is thus a presumption against a conflict between international and national law. In general [according to OPPENHEIM'S INTERNATIONAL LAW (hereinafter "OPPENHEIM'S")],

"[a]lthough national courts must apply national laws even if they conflict with international law, there is a presumption against the existence of such a conflict. As international law is based upon the common consent of the different states, it is improbable that a state would intentionally enact a rule conflicting with international law. A rule of national law which ostensibly seems to conflict with international law must, therefore, if possible always be so interpreted as to avoid such conflict."<sup>12</sup>

Both GATT and WTO Panels have relied on similar reasoning in applying the doctrine. Thus, in *Canada - Aircraft*, the Panel reviewed Brazil's allegation that two of the challenged programmes (Export Development Corporation and Canada Account) required Canada to grant subsidies. The Panel determined, however, that Brazil had not offered evidence demonstrating that subsidization was required under these programmes. Rather, "the grant of subsidies would be the result of the exercise of the administering authority's discretion in interpreting its mandate."<sup>13</sup> In these circumstances, the traditional distinction between discretionary and mandatory legislation prevented the Panel from making findings on the programmes *per se*, and instead required that Brazil establish that the programmes, as applied, granted subsidies.

In addition, a Member may apply legislation in a manner that is consistent with its WTO obligations when it takes action affecting a fellow Member, but may apply the legislation in a manner that is inconsistent with the provisions of a WTO agreement when it acts against a non Member. Therefore, even assuming that PROEX III gives the Committee on Export Credits the ability to act in a manner inconsistent with Brazil's obligations under the SCM Agreement (which Brazil denies), PROEX III certainly does not require that Brazil act in a manner inconsistent with the SCM Agreement. Under this assumption, PROEX III is discretionary and cannot be challenged unless applied in a manner inconsistent with Brazil's WTO obligations.

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<sup>12</sup> OPPENHEIM'S INTERNATIONAL LAW, 9<sup>th</sup> ed., pp. 81-82 (footnote omitted).

<sup>13</sup> *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R (14 April 1999), para. 9.128. For GATT cases applying the doctrine, see, e.g., *United States - Taxes on Petroleum and Certain Imported Substances*, adopted on 17 June 1987, BISD 34S/136 (the Panel found that a U.S. law could not be challenged until it was applied because the U.S. executive possessed authority to apply the law in a GATT-consistent fashion); *Thailand - Restrictions on Importation of an Internal Taxes on Cigarettes*, adopted on 7 November 1990, BISD 37S/200 (the Panel found that the mere existence of a higher tax ceiling on imported cigarettes did not violate Article III:2 of GATT 1947 because an implementing regulation had established an identical tax on both imported and domestic cigarettes); *EEC - Regulation on Imports of Parts and Components*, adopted on 16 May 1990, BISD 37S/132 (the Panel ruled that a measure that allowed, but did not require, the imposition of a tax on certain imported products to avoid circumvention of an antidumping duty order could not be challenged under Article III of GATT 1947 until it was applied and recommended that the EEC never apply the measure); *United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco*, adopted on 4 October 1994, BISD 41S/131 (the Panel found that a U.S. statute was susceptible to many interpretations, including one that would violate Article VIII:1(a) of GATT 1947, but did not find it inconsistent with the GATT because it could also be interpreted and applied in a GATT-consistent manner).

**Q22. The Panel in *United States – Section 301* (WT/DS152/R, para. 7.96) found legislation presumptively inconsistent with the *WTO Agreement* in a case where legislation provided discretion to act in a WTO-inconsistent manner. Do the findings of this Panel on this issue have any relevance to this dispute? Please elaborate.**

Again, as Brazil noted above and during the meeting of the Panel, PROEX III does not allow Brazil to act in a manner that would be inconsistent with Brazil's WTO obligations. It requires that the authorities act in conformity with the provisions of the SCM Agreement. Therefore, the discretionary v. mandatory distinction and the findings in the *Section 301* case are irrelevant. However, even under the assumption that PROEX III is discretionary and allows Brazil to act in a manner inconsistent with the SCM Agreement, the findings of the *Section 301* Panel are not applicable because they are based on very different facts.

In *Section 301*, the EC challenged a provision of US law that, in certain circumstances, required the US Trade Representative to determine whether another country was complying with its WTO obligations before a WTO dispute settlement Panel had issued a ruling on that very question. The EC argued that the US law was inconsistent with Article 23 of the Dispute Settlement Understanding, which specifically states that "Members shall not make a [unilateral] determination to the effect that a violation has occurred" before such a determination is made by the Dispute Settlement Body. The United States defended the measure on grounds that the USTR had the discretion to find that the other country was not acting in a manner inconsistent with its obligations. Consequently, according to the United States, the measure could not be challenged until the USTR had acted, *i.e.*, until it had issued a determination, prior to the completion of the WTO dispute settlement process, that another country had acted inconsistently with its WTO obligations. Thus, the United States explicitly retained the right to make unilateral determinations that were expressly prohibited by the DSU and was, indeed, required by the statute to make such determinations.

The Panel, without departing from the mandatory/discretionary doctrine, found that the vesting of discretion in the government could constitute a violation of the WTO obligations when the discretion is, *in itself*, a direct violation of an express provision of a WTO agreement. These facts are very different from the facts of PROEX III, as the SCM Agreement does not contain any provision expressly preventing a Member from granting some discretion to its Executive.

Brazil does not believe that any provision of PROEX III allows a violation of Brazil's obligations under the SCM Agreement. Canada, however, has raised the issue of spare parts. This issue would arise only if the Panel decides that PROEX III does confer a benefit and that, in order to qualify for the safe haven of the second paragraph of item (k), PROEX III must comply with the interest rates provisions of the 1998 version of the *OECD Arrangement*. In that case, the distinction between the *Section 301* case and the current case is apparent. PROEX III allows financing of spare parts up to 20 percent of the aggregate value of the other goods. It does not expressly reserve the right of Brazil or require Brazil to finance spare parts for regional aircraft in excess of the requirements of the 1998 *OECD Arrangement*.

**Q23. What relevance, if any, does the language of Article 3.2 to the *SCM Agreement* ("A Member shall neither grant nor maintain subsidies referred to in paragraph 1") have to the consideration of PROEX III in this dispute.**

The "grant" nor "maintain" language in Article 3.2. of the SCM Agreement is not relevant to the consideration of PROEX III in this dispute. PROEX III allows neither granting nor maintaining prohibited subsidies. In fact, as Brazil stated before this Panel and in its response to Question 10 above, to date no support has been granted under PROEX III and, therefore – obviously – no subsidies could have been granted or maintained under PROEX III. Subsidies that may have been granted or maintained under the previous versions of PROEX are not at issue in this dispute. Canada has sought and obtained the authorization to retaliate against those subsidies, and they are not within the terms of

reference of this Panel. The only question before this Panel is whether PROEX III is consistent with Brazil's WTO obligations.

**Q24. Please discuss how, if at all, the concept of minimum premiums as reflected in Article 20 of the 1998 OECD Arrangement applies to interest rate support. Why is interest rate support not identified in Article 20 of the 1998 OECD Arrangement? Are minimum premium benchmarks under the 1998 OECD Arrangement available to non-Participants?**

The language of Article 20 of the *Arrangement* expressly limits the application of the minimum premiums to official support provided through direct credits/financing, refinancing export credit insurance and guarantees. Interest rate support, such as PROEX, is expressly omitted from the application of the minimum premiums.

Brazil is, of course, not a Participant in the *Arrangement* and was not involved in the drafting or negotiation of the terms of its terms. Brazil can therefore only offer speculation as to why interest rate support was excluded from the application of the minimum premiums. It is Brazil's understanding that the minimum premiums do not apply to interest rate support because the government providing interest rate support simply makes interest payments and does not assume any of the risk of the transaction. In contrast, governments providing direct financing or guarantees necessarily assume all or part of the risk of the transaction.

While the OECD makes available some information regarding how premiums are to be calculated (the so-called Knaeppen Package), as far as Brazil is aware, the actual premiums are not available to non-Participants in the *Arrangement*.

**Q25. Please state clearly for the Panel your view regarding which provisions of the 1992 and 1998 Arrangement are "interest rates provisions" within the meaning of the second paragraph of item (k).**

As explained in Brazil's First Submission, Brazil understands that the panel in *Canada – Aircraft* used an overly broad approach to identify what it believed were the interest rates provisions of the 1998 *OECD Arrangement*<sup>14</sup>. As explained in its First Submission, Brazil submits that the interest rates provisions of the 1998 version of the *Arrangement* are Articles 15 through 19 of the main text and Article 22 of the Annex<sup>15</sup>. Further, Brazil believes that the interest rates provisions of the 1992 version of the *Arrangement* are those set out in Article 5 of the main text and Article 21 of Annex IV: Sectoral Understanding on Export Credits for Civil Aircraft<sup>16</sup>. These are the only provisions of the *Arrangement* governing the interest rate for a given transaction. The other provisions described by the *Canada – Aircraft* panel as interest rates provisions do not affect the interest rate for the transaction.

For example, Article 7 of the 1998 *Arrangement* requires that purchasers make cash payments equal to a minimum of 15 percent of the export contract value (*i.e.*, only 85 percent of the transaction value may be financed)<sup>17</sup>. This is not an "interest rates provision" because the amount to be financed does not affect the interest rate, but simply the amount of the loan.

Similarly, Article 29(a) of the Annex provides that spare parts financing shall be limited to 20 percent of the value of the transaction. This provision also affects only the amount of the loan;

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<sup>14</sup> *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW (9 May 2000), para. 5.78.

<sup>15</sup> Brazil's First Submission, 16 March 2001, para. 52.

<sup>16</sup> *Id.*, para. 40.

<sup>17</sup> The corresponding provision of the 1992 version of the *Arrangement* is Article 3.

there is no commercial reason why the level of spare parts financing in a given transaction would affect the interest rate for the transaction.

For these reasons, Brazil submits that the ordinary meaning of the term "interest rates provisions" in the second paragraph of item (k) is that it refers only to the provisions of the *Arrangement* that specify the interest rates. If the negotiators had meant to include other terms and conditions, they would have said so.

Brazil also notes that the second paragraph of item (k) purposefully refers to the "interest rates provisions" of the *Arrangement* rather than simply to the "provisions" of the *Arrangement*. In order to give meaning and effect to the inclusion of the words "interest rates" before the word "provisions," the Panel must interpret the second paragraph as requiring that Members that are not Participants in the *Arrangement* apply some, but not all, of the provisions of the *Arrangement*. The only provisions that must be applied are those relating to "interest rates." Accordingly, Brazil submits that the only interpretation of the term "interest rates provisions" that would be consistent with the text would be to limit the term to the provisions of the 1992 and 1998 versions of the *Arrangement* listed in paragraphs 40 and 52 of Brazil's First Submission and above.

Brazil believes that it is especially important to construe the term "interest rates provisions" narrowly if the Panel interprets the second paragraph of item (k) of the SCM Agreement as referring to the 1998, rather than the 1992, version of the *Arrangement*. If the 1998 version is deemed to apply, the Participants in the *Arrangement* will be empowered to change the rules governing officially supported export credits that affect well over a hundred WTO Members that are not Participants in the *Arrangement* and have no say in the formulation of OECD rules. This power must be limited to setting the interest rates governing officially supported export credits only, and should not be expanded to permit unlimited changes in the rules governing export credits.

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#### **Additional question for both parties**

**Q32. With respect to Brazil exhibit 3, please confirm the accuracy of the English translation of Article 3, paragraph 2 of Directive 374. In particular, is the phrase "may be extended to" an accurate translation of "poderà ser ampliado, para até"?**

There is a small typographical error in the translation of Article 3 paragraph 2 of Directive 374. The phrase "poderà ser ampliado, para até" should be translated as "may be extended up to." The word "up" is missing from the translation provided in Exhibit Bra-3.

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#### **Questions from Canada to Brazil**

**Q1. In Exhibit CDA-24, an executive on behalf of Air Wisconsin Airlines Corporation states that Embraer has offered financing to Air Wisconsin but that Air Wisconsin cannot offer further details due to confidentiality commitments to Embraer. Will Brazil obtain Embraer's consent to waive these confidentiality commitments?**

As Brazil explained in its closing statement to the Panel, dated 5 April 2001, Brazil is not responsible for what a sales person from Embraer might say. Brazil is responsible only for interest rate support approved under PROEX III. Brazil has not received an application for interest rate support for sales by Embraer to Air Wisconsin and has not approved any support for this transaction.

Published reports confirm that Air Wisconsin has bought Canadian, rather than Brazilian, regional jets.

**Q2. Canada has provided evidence that Embraer recently offered PROEX financing to SA Airlink for a 15 year term. On 14 December 2000 Embraer announced the sale of up to 70 regional jets to SA Airlink. Has Brazil issued any letter(s) of commitment in respect of the SA Airlink sale *other than under PROEX III*? If so, will Brazil provide it/them to the Panel? Have any applications been made to the Committee on Export Credits or to any other authority of the Government of Brazil to provide financing in support of the SA Airlink sale? If so, will Brazil provide it/them to the Panel?**

As Canada itself has acknowledged, the sole issue before this Panel is whether PROEX III constitutes a prohibited export subsidy. As stated above, Brazil has not issued any letters of commitment under PROEX III. Accordingly, none of the information requested by Canada is relevant to the matters before this Panel.

**ANNEX B-6**

**BRAZIL'S COMMENTS ON RESPONSES  
TO QUESTIONS BY CANADA AND THIRD PARTIES**

**(20 April 2001)**

**Canada's Replies**

**Question 15**

1. Brazil finds Canada's response difficult to understand. Canada seems to be saying that PROEX can *never* be in conformity with the SCM Agreement because, "however it is delivered, it enables Brazil to continue to grant prohibited export subsidies." This contradicts prior statements of Canada. In its second oral statement to the original Panel, Canada stated that it "would not have brought this case" if only "PROEX simply reduced the net interest rate offered to an airline to one that is above LIBOR or OECD rates."<sup>1</sup> In responding to the questions of the first Article 21.5 Panel, Canada unambiguously stated that "the relevant benchmark against which a net interest rate must be compared to determine whether a material advantage has been secured is CIRR."<sup>2</sup> Canada's response appears to be just one more example of Canada's practice, indulged in throughout these proceedings, of constantly moving the goal post.

2. Canada also states that it "is also challenging PROEX III payments made in support of regional aircraft exports." Yet, Canada has been unable to point to a single instance of a PROEX III payment made in support of regional aircraft exports, for the very good reason that there have been none.

3. Canada's moving of the goal posts, and its reliance on non-existent transactions cannot obscure the fact that the sole issue before this Panel is not what PROEX I and II, provided, or how they were applied in practice. The sole issue is whether PROEX III, on its face, by its terms, conforms to Brazil's obligations under the SCM Agreement.

**Question 16**

4. Brazil believes that Canada has misinterpreted both Article 13 of the *OECD Arrangement* and the provisions of PROEX. While Brazil is not a Participant in the *Arrangement* and therefore was not privy to the intent of the Participants in its drafting, Article 13 does not appear to contain any mandatory provisions. Unlike, for example, Article 15 governing minimum interest rates (the parties "shall apply"), Article 13 merely states that parties shall "normally" require the repayment of principal to begin within six months. Further, Article 13(c) describes this as a "practice" rather than a "rule" or "requirement."

5. Brazil previously has explained that it does not consider Article 13 to be an "interest rates provision" of the *Arrangement* within the meaning of the second paragraph of item (k). Even assuming that Article 13 is an "interest rates provision," however, the Article does not establish any mandatory requirement. Therefore, the fact that a Member's export credit practices may not conform exactly with the discretionary provisions of Article 13 should not prevent that Member's practices from qualifying from the safe haven of the second paragraph of item (k). Brazil further notes that Article 13(c) requires Participants in the *Arrangement* that do not intend to follow the "practice" of Article 13 to notify other Participants. There is no requirement that WTO Members that are not

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<sup>1</sup> *Brazil - Export Financing Programme for Aircraft*, Canada' Second Oral Submission to the Panel, para. 109.

<sup>2</sup> Original Article 21.5 Panel Report, page 89 (Canada's Response to Question 12 of the Panel).

Participants in the *Arrangement* be notified, and no means by which they could obtain this information. In these circumstances, WTO Members should not be required to conform to a "practice" of which they may not even be informed in order to qualify for the safe haven.

6. Brazil also disagrees with Canada's interpretation of the language of Article 13, in that the phrase "shall normally" qualifies both the reference to "equal and regular instalments" and the reference to "first instalment" later in the same sentence. The text does not support Canada's interpretation. Moreover, the subsequent language of Article 13 (b) and (c) refers to subsection (a) in the singular ("this profile" and "this practice"), indicating that Article 13(a) is to be read as a unitary whole, rather than establishing separate degrees of obligation for the "equal and regular" instalments and the "first instalment," as Canada suggests.

7. Canada's reference to Article 27(a) is also misplaced in that Article 27(a) states that Participants may not extend the repayment term of a loan by delaying the first payment of principle. This merely confirms the language of Article 10 governing maximum repayment terms, but does not appear to affect the interpretation of the word "normally" in Article 13(a).

8. Canada's interpretation in paragraph 3 of its answer of Article 2 of Brazil's Directive 374 is also misplaced. Brazil notes that Article 3, paragraph 1 of Resolution 2799 requires that interest shall be payable every six months on the outstanding balance of principal, starting from the date of shipment or delivery of the goods. Article 4 provides that the amounts due and payable for interest rate support shall be based on the same terms as the interest accrual term, including a maximum grace period of six months for the repayment of the principal.<sup>3</sup> Brazil notes also that this is consistent with the approach of the Article 22.6 Arbitrators, who assumed "semi-annual constant instalments for capital reimbursement" under PROEX.<sup>4</sup> These requirements limit any flexibility granted under Article 2 of Directive 374 regarding the terms and grace periods for principal. It is, therefore, incorrect for Canada to assert that PROEX III would not "respect" the "normal" practice of Article 13(a) of the *Arrangement*.

### Question 17

9. The real answer is admitted by Canada in the first sentence of its response: "The 1998 OECD Arrangement does not define 'interest rate support.'"

10. Canada states that PROEX III payments "are significantly different from the interest rate support practices of the Participants." Canada claims that interest rate support provided by the Participants varies according to the difference between the prevailing short-term rate and the rate that was fixed for the borrower. Brazil has no basis for agreeing with or disputing this statement, as the *Arrangement* is silent on the point, and Canada has never offered any evidence concerning the interest rate support practices of Participants. Regardless of the practices of Participants, however, the practices of the Participants do not exhaust the field, and, even if they differ from PROEX, do not mean that PROEX is not interest rate support.

11. As Canada describes the interest rate support practices of Participants, it would appear that PROEX may place more risk on the lender than do those practices. PROEX is a fixed amount, and will not be adjusted upward if short-term rates rise. Thus, under PROEX, lenders are required to assume the entire risk of interest rate changes during the life of the loan.

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<sup>3</sup> Brazil notes that there is a typographical error in the English version of Resolution 2799 in Exhibit Bra-1, which rendered the Portuguese "máxima" into the English "minimum" in describing the permitted period of grace for the repayment of principal. The translation should read "maximum grace period."

<sup>4</sup> *Brazil – Export Financing Programme for Aircraft – Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS46/ARB (28 August 2000), para. 3.82.

12. In the second bullet point to its second paragraph, Canada seems to suggest that PROEX III does not qualify as "interest rate support" because it is a one-way flow from the government to the bank instead of a two-way flow, "associated with interest rate equalization." Canada neglects two important points. First, whatever the flow between the government and the bank is, the effect on the borrower is the same: the borrower always receives funds at the same rate. Second, in the case of a "two-way flow" the bank is always guaranteed its margin of profit. If it makes more than the agreed margin, it will have to pay the difference to the government, but if it makes less the government will compensate it for the difference. In the case of a "one-way" flow, the bank takes all of the risk: its profit margin is not guaranteed and it can still incur losses depending on how the market moves.

13. In the third bullet-point to paragraph 1 of its response, Canada appears to criticize Brazil for not providing enough support through PROEX. It may well be, as Canada says, that "Participants provide credit risk insurance or guarantees in conjunction with interest rate support to cover [the risk of non-repayment from the borrower]." If so, this is support that PROEX does not provide. PROEX provides no protection to the lender for possible default by the borrower.

14. Finally, Canada's assertion that "PROEX is divorced from the interest rate that prevails in the market when the transaction is approved," is contradicted by the express terms of PROEX which, on their face, explicitly make the market a reference for PROEX.

### Question 18

15. Brazil believes Canada's response does not make clear that the question of a "benchmark" is relevant only to Brazil's item (k) first paragraph defense. Benchmarks are not relevant to Brazil's other defenses (1) that PROEX III does not confer a benefit and therefore is not a subsidy and (2) that, in any event, PROEX III is eligible for the safe haven of item (k) second paragraph. As Brazil pointed out during the hearing, PROEX III does not confer a benefit because the CIRR is not the mandatory interest rate but the minimum, the floor, rate. Under Article 8, paragraph 2 of Resolution 002799, the interest rate must be determined on the basis of the rate available in the international market. Thus, under Resolution 2799 it is the international market, not the CIRR, that is the benchmark. As for Brazil's second defense – that PROEX III is eligible for the safe haven of item (k) second paragraph – that defense does not require establishing a benchmark. All Brazil needs to show is that it complies with the interest rates provisions of the *OECD Arrangement* which, as far as the rate of interest rate support, requires the CIRR.

16. The substance of Canada's response with regard to the benchmark is contradictory. It is quite clear that, as the Panel's question suggests, the Appellate Body was aware of the financing spreads required from airlines purchasing regional aircraft when it concluded that the CIRR was an appropriate benchmark. The Appellate Body stated that, "We believe that the *OECD Arrangement* can be appropriately viewed as one example of an international undertaking providing a specific market benchmark by which to assess whether payments by governments, coming within the provisions of item (k) are 'used to secure a material advantage in the field of export credit terms.'"<sup>5</sup> Yet Canada states that it "has challenged Brazil's selection of the CIRR as an appropriate benchmark."

17. The Appellate Body made it abundantly clear that the CIRR would serve as a benchmark and that, while other rates in fact might or might not confer a material advantage, it was up to the party urging that fact to prove it. This, in Brazil's view, was the basis of the original Article 21.5 Panel's determination that Brazil had not established that PROEX II, in adopting a benchmark lower than CIRR, did not confer a material advantage.<sup>6</sup>

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<sup>5</sup> *Brazil – Export Financing Programme for Aircraft*, AB-1999-1, WT/DS46/AB/R, para. 181 (2 August 1999).

<sup>6</sup> *See, e.g., Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW paras. 6.92 and 6.93 (9 May 2000).

18. Brazil must confess to some confusion about just what Canada's position is regarding the CIRR and the market. In paragraph six of its response to Question 18, Canada states that the airline with the best credit rating is American Airlines, and that the CIRR is 35 basis points lower than the rate American Airlines is able to achieve in the market. Canada made this point as well at paragraph 78 of its First Submission. As authority for the statement in its First Submission, Canada refers to page 13 of its Exhibit 17 which ostensibly shows that the debt of American Airlines trades at between 135 and 200 basis points above US Treasury rates which is, at a minimum, 35 basis points above the CIRR.

19. First, Brazil would point out that the securitization of aircraft *leases* is an operation that does not directly reflect the terms of the *original loan* itself. This complex and recently developed financial operation involves a number of additional steps. The enhanced equipment trust certificate ("EETC") securitization enhances the creditworthiness of traditional equipment trust certificates ("ETCs") secured by lease receivables and the leased aircraft as follows: first, the issuer of the EETCs is bankruptcy remote (and insulated from a bankruptcy of the lessee) to the satisfaction of the rating agencies; second, the EETCs are tranching to take advantage of the expected residual value of the aircraft, *i.e.*, the lower the advance level, the higher the rating; third, a liquidity facility is provided to ensure the continued payment of interest on the EETCs during the remarketing period following a possible default by the lessee. The term of the liquidity facility in an EETC securitization relies on the ability of a lessor to repossess an aircraft from a bankrupt lessee, if the lessee does not elect to perform.

20. The first EETC structure was closed by Northwest Airlines in 1994. As described above, the rating agencies concluded that the underlying corporate credit of a single airline could be enhanced through a combination of the ability to repossess and remarket the leased aircraft within a limited eighteen month period during which interest would continue to be paid by a liquidity facility. This was combined with tranching debt, to achieve ratings for all of the EETC classes of debt that were higher than that of the airline.

21. The securities of the EETC structure are offered in the secondary market and their prices then oscillate according to the financial market trends, with spreads that respond to various economic and market indicators (such as the behavior of the markets of stocks and bonds) that maintain no relationship whatsoever with the original financial structure of the loan obtained by the lessor when purchasing the aircraft. The spreads mentioned by Canada reflect nothing more than investors return expectations based on a range of commercial papers, with comparable coupons, yields, maturities, credit ratings, etc.

22. Canada's Exhibit 17 itself demonstrates the flaws in Canada's reasoning. With regard to its American Airlines illustration, on page 6 of Exhibit 17, it is stated that American Airlines "was placed on Watchlist negative by Moody's and CreditWatch negative by S&P after it proposed to acquire the assets of TWA and a portion of the assets of US Airways." This demonstrates that the papers from American Airlines today do not enjoy the same credit ratings that the airline once enjoyed.

23. Moreover, Canada's reliance on the January 2001 spread for American Airlines – or any airlines – is misplaced. That spread simply represents the current yield on the instrument. It has nothing to do with the original spread, at the time the EETCs were issued. In the case of American Airlines these ranged 112 to 147, considerably lower, but still above CIRR. However, as Exhibit 17 itself shows, many of the original spreads were below CIRR. This is the case for the very first transactions listed, for America West. It is also the case for a number of the Continental Airlines transactions listed.

24. One of the Continental transactions is particularly instructive – those issued on September 12, 1997 covering nine Embraer 50 seat 145 regional jets. This is set out on page 14 of Canada's

Exhibit 17. The offering spread on those transactions ranged from 90 to 100 – in other words, from 10 basis points below the CIRR to the CIRR. This transaction, as Exhibit 17 shows, was comparable to other rates at the time. It was also before PROEX III. More important, following Canada's logic with its American Airlines example, Embraer's paper today is trading at 115 to 160 points above the CIRR – so what is Canada's problem?

25. These distinctions between the securitization of leases and the terms of the original loan may be the key to understand Canada's departure from its previous statements defending the adequacy of the CIRR as a benchmark. As the panel recalls, before the *Canada – Aircraft* Panel, Canada said that the CIRR is, "by definition, 'close to commercial rates.'"<sup>7</sup> Moreover, before the Article 21.5 Panel in *Brazil – Aircraft*, Canada said that financing offered by its Export Development Corporation ("EDC") at rates *below* the CIRR were, nevertheless "commercial" and did not confer a benefit within the meaning of Article 1 of the SCM Agreement.<sup>8</sup>

26. Finally, simply taking Canada's analysis as it is given, Canada does not explain how it is possible for the debt of the airline with the best credit rating to trade at 35 to 100 basis points above the CIRR when, at the same time, its own lending to airlines *below* the CIRR is "commercial."

27. Beyond this, Brazil cannot clarify this situation, but fortunately, Canada is in a position to do so. The American Airlines debt reported in Canada's Exhibit 17, at page 13, concerns only large civil aircraft manufactured by Boeing. No regional aircraft are included. However, the Canadian producer, Bombardier, itself has sold its 70-seat aircraft, the CRJ 700, to American Airlines' wholly owned regional carrier, American Eagle. Brazil understands that financing for this transaction was provided by EDC through its "market window" operations. In Canada's view its market window operations do not provide "official support," and are purely "commercial." Canada could, therefore, shed light on this matter by providing the Panel with the terms and conditions, including the interest rate, it offered or provided to support Bombardier's sale of the CRJ 700 to American Eagle.

28. Brazil would note that at the time of the transaction, Bombardier was the only producer in the world offering a 70-seat regional jet. Therefore, its transaction with American Eagle would have been on terms uninfluenced by competition.

### Question 19

29. Brazil disputes Canada's claim that it "has demonstrated that the CIRR is not an appropriate generalized market benchmark because it does not generally reflect the rates available in the commercial marketplace for the financing of regional aircraft." Canada has produced *no* evidence concerning "the commercial marketplace for the financing of regional aircraft" despite the fact that Canada's EDC participates in that market. As Brazil noted above in its comment to Canada's response to Question 18, the only market evidence Canada has offered concerns the secondary market for American Airlines debt secured by large commercial aircraft.

### Question 20

30. In Brazil's view, the Appellate Body considered the CIRR as a generalized market benchmark both because it is based on reasonably current market interest rates, and is a published, objectively derived rate that is easily administrable in the context of item (k) first paragraph. While a WTO Member is free to urge another rate, that Member has the burden of proof, a burden that Brazil in the

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<sup>7</sup> *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R at paras. 6.167, 9.223 (14 April 1999).

<sup>8</sup> *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, para. 6.99 (9 May 2000).

original Article 21.5 proceeding found difficult to meet, as does Canada here, albeit for different reasons.

31. The burden was impossible for Brazil because, while it was established that Canada provided support below the CIRR, Brazil could not establish with the required precision how far below Canada's rate was, and how that rate related to the market overall. Lack of transparency on the part of Canada and others in the market was a barrier Brazil could not surmount. Here, the barrier Canada cannot surmount is based on its unwillingness to disclose to the Panel the details of its own market operations. The consequence is, as Brazil noted above in its comment on Canada's response to Question 19, that Canada has offered only evidence of the secondary market for debt on large civil aircraft produced by Boeing, not for the original market for regional aircraft produced by Bombardier in which Canada participates.

### Question 21

32. Canada's response admits that under the traditional distinction between mandatory and discretionary measures it is not sufficient to show that a measure might allow a Member to violate its WTO obligations but rather that the measure requires a Member to violate its WTO obligations. But then Canada argues that this distinction applies to every WTO provision with one exception: the second paragraph of item (k). Canada states that the mandatory v. discretionary distinction does not apply here because Brazil has the burden to establish an affirmative defense.

33. The premise of Canada's argument is false for several reasons. To begin with, Brazil's first argument is that PROEX III does not confer a benefit. This is not an affirmative defense. Canada must establish a *prima facie* case that PROEX III does confer a benefit.

34. Further, it is true that Brazil's second defense – the safe haven under the second paragraph of item (k) – is an affirmative defense and Brazil has the burden of proof. However, the mandatory v. discretionary distinction has nothing to do with the burden of proof. It is a substantive standard. Once Brazil establishes a *prima facie* case that PROEX III allows compliance with the interest rates provisions of the *OECD Arrangement*, PROEX III should, under the traditional mandatory v. discretionary distinction, be considered to be in conformity with Brazil's WTO obligations until Canada proves otherwise. As Brazil has shown, PROEX III allows the Executive to comply with the interest rates provisions of the *Arrangement* even if it might also allow Brazil not to comply with those provisions.

35. Brazil notes that when a WTO Member decides to challenge a measure of another Member, it has two options. It can challenge the measure either as applied or the measure as such. When making that choice the Member also makes a choice concerning the evidence it needs to submit in order to establish a *prima facie* case. Canada chose to challenge PROEX III as such. Therefore, under GATT/WTO jurisprudence and the mandatory v. discretionary doctrine, Canada imposed on itself the burden to prove that PROEX III *requires* action that would constitute a violation of Brazil's WTO obligations. This was Canada's choice, not Brazil's. It was Canada's choice to rush and file this dispute – accusing Brazil of dragging its feet – without an appropriate opportunity for bilateral consultations.

36. Thus, contrary to Canada's assertions, under the mandatory v. discretionary doctrine, the burden of proof is quite different. Canada must establish that PROEX III requires Brazil to violate its WTO obligations. Brazil, on the other hand, needs only to show that PROEX III is discretionary and allows the Executive to apply it in a manner fully consistent with the WTO. Once Brazil meets that burden of proof, PROEX III, under the traditional mandatory v. discretionary doctrine, must be considered to be in conformity with Brazil's WTO obligations.

37. In this answer, Canada again refers to "evidence" that "establishes" Brazil's failure to comply with the interest rates provisions of the *Arrangement*. One assertion – that Directive 374 on its face allows financing for a period exceeding 10 years – will be addressed in Brazil's comments on Canada's response to Question 32. Brazil would like to point out, however, that Canada keeps referring to "unrebutted evidence" about Brazil's non-compliance without identifying that evidence. Brazil has submitted the evidence that must prevail in these proceedings: the documents constituting PROEX III. All Canada has submitted in exchange is newspaper reports. Canada has now – for the first time – attempted in its answers to claim that Directive 374 on its face allows financing for a period exceeding 10 years. As Brazil will show in its comment on Question 32, this assertion is untenable.

#### **Question 22**

38. Canada repeats its unsubstantiated assertion that Brazil has not shown that PROEX III allows for an application that is consistent with the SCM Agreement. Canada, however, has not, by any reasonable standard, even remotely made a *prima facie* case that PROEX III *requires* a violation of Brazil's WTO obligations.

39. Further, Canada misinterprets the *Section 301* case. It is incorrect to state, as Canada does, that "the *Section 301* panel found legislation to be presumptively inconsistent with the WTO Agreement in a case where legislation provided discretion to act in a WTO-inconsistent manner." In *Section 301*, the US legislation *required* USTR, under certain circumstances, to make a unilateral determination on whether another government acted in compliance with its WTO obligations. While USTR retained the discretion to determine whether another government acted in compliance with its WTO obligations, it was required by the legislation to make that determination unilaterally. Thus, the *Section 301* finding is not inconsistent with the traditional mandatory v. discretionary distinction and is not applicable to the facts of this case. PROEX III, contrary to Canada's assertion, does not *require* that Brazil act in a manner inconsistent with its WTO obligations.

#### **Question 23**

40. Brazil has not granted any subsidies under PROEX III; therefore, Brazil does not maintain any subsidies under PROEX III.

#### **Question 24**

41. Brazil would like to refer the Panel to the answer provided by Korea, as a third party, to Question 27. Korea's answer contains a detailed and persuasive explanation as to why the concept of minimum premiums does not apply to interest rate support.

42. Canada seems to provide support for Brazil's view, also shared and supported with detailed arguments by Korea. In the second paragraph of its answer to Question 24, Canada argues that interest rate support does not remove the risk of non-payment by the borrower for the lending institution. Brazil agrees. That risk is removed only when the government assumes it by providing interest rate support in association with a guarantee or insurance. PROEX III does not do that (and Canada has never argued that it does). This is precisely why Article 20 of the 1998 *Arrangement* does not apply to PROEX.

43. Finally, as Canada is compelled to admit, the minimum premium benchmarks defined by the participants in the *OECD Arrangement* are *not* available to non-Participants. Yet Canada – and the EC and the US – argues that the 1998 version of the *Arrangement* is the relevant version. They would require Members of the WTO to comply with commitments that they cannot even know about.

## Question 25

44. Brazil already has enumerated the provisions of the OECD Arrangement it considers as "interest rates provisions" and will not now restate those provisions. However, Brazil disagrees with Canada's views on this issue and has the following comments.

45. Canada states that its interpretation encompasses provisions that "affect what the interest rate and the amount of interest payable will be in a given transaction." However, many of the provisions listed by Canada have nothing to do with the interest rate or even the amount of interest. Thus, provisions of the Arrangement such as Article 7, governing cash payments, and Article 9, governing the starting point of credit, affect important – indeed even critical – terms of a transaction, but they simply do not affect the interest rates.

46. A more significant problem with Canada's definitions is that Canada continues to include in its definition the matching provisions of Article 29 of the *Arrangement*. The matching provisions of Article 29 require that Participants notify each other in the event that they depart from the provisions of the *Arrangement* in order to match terms and conditions offered by either Participants or non-Participants. Brazil does not agree that a decision *not* to follow the interest rates established in the *Arrangement* and the provisions governing that decision can in themselves constitute *interest rates provisions*. This is clear from the language of the *Arrangement* itself, which allows Participants to match "credit terms and conditions." This term must necessarily be broader than the term "interest rates provisions" as used in the second paragraph of item (k), as it appears to encompass *all* the credit terms and conditions of a transaction, rather than simply the *interest rates* provisions referred to in item (k). The *Canada - Aircraft* Article 21.5 Panel also found that the term "interest rates provisions" could not be read to refer to *all* of the provisions of the *Arrangement*, as that would "seriously undermine the disciplines of the SCM Agreement."<sup>9</sup>

47. Moreover, the *Arrangement* does not require Participants to notify non-Participants of their intent to "match" non-conforming offers either by other Participants or by non-Participants. If Canada's definition of the term "interest rates provisions" is correct, therefore the second paragraph of item (k) means either that (1) the second paragraph of item (k) creates different rules for Participants in the *Arrangement* (who may match) and non-Participants (who may not), or that (2) non-Participants in the *Arrangement* must also be permitted to match. There is no legal basis for the first interpretation, as the entire purpose of the second paragraph is to enable Members that are non-Participants in the *Arrangement* to abide by the same rules as the Participants; and the second interpretation would render the safe haven of the second paragraph redundant, in that non-Participants could simply match in every instance.

48. For these reasons, the term "interest rates provisions" as used in the second paragraph must be interpreted literally to refer to the provisions of the *Arrangement* that establish *interest rates*, and not to provisions that govern the other terms of the transaction. Had the drafters of the SCM Agreement intended otherwise, they would have referred to "the provisions of the relevant undertaking" or "the credit terms and conditions of the relevant undertaking" making it clear that all the provisions of the *Arrangement* must be complied with.

## Question 32

49. Canada's translation of this provision is simply wrong. This is the first time Canada advances the argument that PROEX III on its face allows financing for a period of 10 years *to be extended for an additional period of 8 years*. Such a reading of the text of Directive 374 is incorrect. This is not

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<sup>9</sup> *Canada - Measures Affecting the Export of Civilian Aircraft - Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW (9 May 2000), para. 5.113.

what the drafters said or intended to say. In fact, such an interpretation would probably have never occurred to them had Canada not advanced it in these proceedings.

50. The Portuguese phrase "poderá ser ampliado para até" means "may be extended up to" ("jusqu'à" in French, "hasta" in Spanish). The Annex to Directive 374 provides for the maximum term of financing for the specific categories of goods, category by category. For aircraft, it is a maximum of 10 years. Article 3, paragraph 2 of Directive 374 provides that the term of interest rate support may be extended up to a certain period contingent upon the value of the goods.

51. Thus, for example, according to the Annex, the term for interest rate support for balloons cannot exceed 7 months. Under Article 3, paragraph 2, assuming balloons are in the first category, between \$1,000 and \$5,000, the maximum tenure can be extended from 7 months up to a maximum of 12 months. The provision of Article 3, paragraph 2, is not relevant for aircraft. The maximum term under that provision is 8 years. The provision of the Annex, specific to aircraft, allows financing for a maximum term of up to 10 years. Thus, the ceiling under the Annex is higher than the ceiling of Article 3, paragraph 2, and no further extension is allowed. As Brazil has stated on numerous occasions, the exception from this rule can be based only on the provision of Article 8, paragraph 2 of Resolution 2799 which allows the Committee to extend the term of financing if different terms are available in the international market.

### **Third Party Responses**

#### **European Communities' Responses**

##### **Question 27**

52. Brazil agrees with the EC's statement in its response to Question 26 that PROEX III "is therefore interest rate support within the meaning of Article 2." However, Brazil does not agree with several points raised by the EC in its response to Question 27.

53. The EC at great length discusses risk premiums, but the 1998 version of the *Arrangement* refers only to country risk, not to company risk, and, as the EC admits, those country risk benchmarks are not available to non-participants. There are no references to risk premiums in the 1992 version of the *Arrangement*, the version that was incorporated by the WTO in 1995.

54. In Brazil's view, the point made by the EC in paragraph 7 of its response demonstrates forcefully why the term "interest rates provisions" in the *Arrangement* should be interpreted narrowly, and why the Panel should conclude that it is the 1992 version of the *Arrangement* that is relevant, not the 1998 version, adopted three years after the WTO came into being.

55. The EC describes the OECD and its *Arrangement* as if it were an exclusive club, which perhaps it is. The *Arrangement* is a "gentlemen's agreement" and, "One consequence of this is that circumvention of its provisions is not considered legitimate." However, WTO Members are entitled to know with reasonable clarity and precision what rules they are and are not expected to observe. They are not to be left to the vague standards of etiquette that a group of gentlemen sitting in Paris consider appropriate.

#### **Korea's Response**

##### **Question 26**

56. Note 53 from the original Article 21.5 Panel Report, quoted by Korea in its response, is a generally accurate description of PROEX III.

**Question 27**

57. Korea accurately observes that, "The concept of minimum premiums does not apply to interest rate support" and that the *Arrangement's* minimum premium benchmarks are not even available to non-Participants.

**United States' Response****Question 26**

58. Brazil agrees with the statement of the United States, in the first paragraph of its answer, that, "The purpose of the [OECD] arrangement is to allow the commercial bank to provide fixed rate financing at the appropriate CIRR rate." This is precisely what PROEX III does.

59. The United States goes on, in that paragraph, to describe much of what PROEX III does *not* do. PROEX does *not* compensate the bank for its own floating rate funding risk. Beyond its fixed, maximum 2.5 percent payment, PROEX does *not* pay interest rate shortfalls to the bank depending upon the relationship between the fixed rate of the loan and the floating rate during the life of the loan. If, as the United States maintains, "most OECD governments offering interest rate support" also offer this kind of protection, they are offering much more than PROEX III offers.

60. PROEX III meets the criteria the United States sets out in the second paragraph of its response: (a) the interest rate the borrower sees after the interest rate support is the appropriate CIRR and (b) PROEX is not offered in a manner or at a level that is used to cover other costs of the borrower.

**Question 27**

61. The US states that "when a government does offer interest rate support in conjunction with insurance or a guarantee, the government must charge the appropriate minimum premium rate because it is providing insurance or guarantee cover." Thus, the US acknowledges that the only reason to charge a premium rate is to cover insurance or a guarantee – not for interest rate support. Since PROEX III does not provide insurance or guarantee cover, there is no need for a premium.

62. In the second paragraph of its answer (paragraph 4 of the document) the United States provides the web address of the OECD for the benefit of Brazil and the other 110 or more non-participant WTO Members. The EC, in its Third Party Submission – *noblesse oblige* – was good enough to do the same. While it is kind of the US and the EC to tell Brazil and the rest of the developing world how to find the OECD on the web, the point is that WTO Members should not be required to check the web site of the OECD in order to learn the nature of their WTO obligations. This is all the more reason why the Panel should conclude that the 1992 version is the relevant version of the *Arrangement* for purposes of item (k) second paragraph.

**Question 29**

63. The US admits that *Arrangement* Participants make notifications of non-conforming terms available to each other, but not to non-participants. While the US states its willingness to support reform of this procedure within the OECD, this is hardly a compelling argument for concluding that non-participants should be bound by the provisions concerned. It also demonstrates the elusive and changing character of the "gentlemen's agreement," and is further argument why the more clear, and now fixed, terms of the 1992 version of the *Arrangement* are those that were incorporated into item (k) second paragraph.

### Question 30

64. The argument of the United States in support of its contention that the negotiators meant "provisions" of the *Arrangement* rather than the "interest rates provisions" suggests that the Panel should impose added disciplines on WTO Members in order not to inconvenience the 30 Members who choose to belong to the OECD. To permit Members to qualify for the safe haven by applying only the "interest rates provisions," the US claims, "would undermine the disciplines of the *Arrangement*."

65. It is not the task of this Panel to undermine or to avoid undermining the OECD and its *Arrangement*. It is the task of this Panel to interpret item (k) second paragraph, a provision adopted by the entire Membership of the WTO in light of their objects and purposes, which had nothing whatsoever to do with the objects and purpose of the OECD. If a sub-set of WTO Members wishes to participate in other international organizations, they are, of course, free to do so. But they should not be heard to suggest that WTO Panels have any responsibility whatsoever to interpret WTO provisions in light the "disciplines" of those other organizations.

66. The WTO Membership did not adopt the entire *Arrangement* and the Participants should be permitted to drag that entire Membership into whatever non-interest rates provisions the *Arrangement* may contain, or into future amendments of the interest rates provisions themselves.