ANNEX C

SUBMISSIONS OF THIRD PARTIES

ANNEX C-1

**SUBMISSION OF THE EUROPEAN COMMUNITIES
AS A THIRD PARTY**

(23 March 2001)

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I. INTRODUCTION

1. The European Communities (hereafter "the EC") makes this third party submission because of its systemic interest in the correct interpretation of the Agreement on Subsidies and Countervailing Measures ("*SCM Agreement*").

2. The questions before the Panel are of considerable importance and complexity. The EC hopes that the comments it offers below will help the Panel in its task. It also hopes that the Parties will provide it with all their submissions to the first and only meeting of the Panel (including therefore their second written submissions), as required by Article 10.3 *DSU*, so that it can make a further contribution at the meeting with the Panel.

3. As an original signatory of, and a current participant in, the only international undertaking satisfying the conditions of the second paragraph of item (k) of the Illustrative List in Annex I to the *SCM Agreement*, that is the *OECD Arrangement*, the EC considers its close involvement in the work of this Panel to be particularly important.

II. SCOPE OF THIS PROCEEDING

4. The EC understands that the present proceeding does not concern contracts covered by PROEX I and II and that the question before the Panel is whether PROEX III is consistent or not with the *SCM Agreement*.[1]

5. The only basis on which the EC can express an opinion on this issue is from the terms of the new scheme as described in Section III, paragraphs 7 to 9 of Brazil's first written submission to the Panel and the documents referred to therein.

6. The EC notes that the only change in the scheme described by Brazil is the introduction of a requirement to comply with CIRR and that:[2]

> 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 Letter No. 002881 sets the maximum allowable interest equalization payment at 2.5 percent.[3] 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*.
>
> 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.[4] Directive 374 also establishes a maximum financing term of 10 years for regional jet aircraft.[5]

7. Canada seems to agree since it states that:[6]

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[1] First written submission of Canada, paragraph 19.

[2] First written submission of Brazil, paragraphs 8 and 9.

[3] Brazil's footnote: The original Portuguese version and the official English translation of Circular Letter No. 002881 are attached as Exhibit Bra-2.

[4] Brazil's footnote: The original Portuguese version and the official English translation of Directive 374 are attached as Exhibit Bra-3.

[5] Brazil's footnote: *Id*., Annex, NCM Heading 8802 (attached as Exhibit Bra-3).

[6] First written submission of Canada, paragraph 12.

In effect, the only discipline that Resolution 2799 imposes on PROEX payments is that they must be "in accordance with the CIRR".

8. The EC notes Canada's view that the scheme allows considerable flexibility and that the new scheme can be for unlimited periods and for 100% of the contract amount. The EC does not dispose of the necessary information to express a view on how Brazil does or will apply PROEX III and can only reserve its position on this question.

III. LEGAL ARGUMENT

9. Brazil makes three arguments in its defence:

- That PROEX III confers no benefit since financing is provided at CIRR which is at or above the "market rate";
- That PROEX III falls within the "safe haven" of the second paragraph of item (k);
- That PROEX III falls under the *a contrario* exception of the first paragraph of item (k).

10. These arguments will be considered in turn.

A. THE EXISTENCE OF A SUBSIDY

11. The EC does not agree that interest rate equalisation in the form offered in PROEX III does not confer a benefit for the purposes of Article 1 of the *SCM Agreement*.

12. It is paid to reduce the interest payment of a commercially negotiated contract by up to 2.5% per annum. It therefore inevitably – indeed *ex hypothesi* – provides a benefit compared with the market rate and thus a subsidy.

13. This conclusion is not contradicted by the various statements that Brazil refers to from the Norwegian export credit agency,[7] Mr Stafford and Mr Fumio Hoshi?[8]

14. These statements relate to whether the CIRRs actually correspond to rates available to first class borrowers in all cases and in no way support the suggestion that such rates are available to all borrowers on the market (especially in the absence of a guarantee or other security).

B. THE OECD SAFE HAVEN

1 . **The applicable version of the** OECD Arrang -0.1275 -174.7

15. Brazil's main defence is now that PROEX III falls under the safe haven of the second paragraph of item (k) of Annex I to the

second paragraph of item (k) of Annex I to the makes a

Agreement may depend on decisions taken elsewhere. For example, Article XXI GATT 1994 allows Members to take action required by resolutions of the Security Council of the United Nations, which can lead to prohibitions of trade under a sanctions regime.

26. The change in the rights and obligations of Members resulting from changes in the *OECD Arrangement* is also analogous to the change resulting from the expiry of Articles 6.1, 8 and 9 of the *SCM Agreement* pursuant to its Article 31, which also did not require the application of Article IX of the *WTO Agreement*.

27. As for Article 3.2 *DSU*, this only provides that dispute settlement should not change the rights and obligations of Members, not that no provision of the *WTO Agreement* can be construed as allowing changes to what is permitted and not permitted by those provisions over time.

28. Brazil also argues that "amendment" of item (k) in this way would not be transparent, would conflict with the object and purpose of the Agreement),[15] that it cannot be presumed that the WTO Members intended to give a small group of them the right to change the rights and obligations under the WTO Agreement and that such a power would be manifestly absurd and unreasonable.[16]

29. The EC disputes that the changes in the *OECD Arrangement* are untransparent. The current version of the *OECD Arrangement* is publicly disclosed by the OECD and is available on the OECD web site.[17]

30. 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.

31. However, it is not unprecedented in the *WTO Agreement* for a small number of Members to be in a position to adopt texts that are of significance for all Members. Both the *SPS Agreement* and the *TBT Agreement*[18] require Members to base their measures on international standards when these are available and there are no imperative reasons for doing otherwise. These international standards can be drawn up by small numbers of WTO Members (and even non-Members) within the framework of other international organisations, such as Codex Alimentarius Commission in the case of the *SPS Agreement*.

32. There are objective reasons for the *SCM Agreement* to refer to rules established within the framework of the OECD: it is mainly the OECD Members who use export credits and have the necessary expertise and interest in developing the disciplines.

33. The EC would also point out that the WTO Secretariat is invited to attend the meetings of the participants in the *OECD Arrangement* and thus could be informed of any new development. The OECD Secretariat would certainly inform the WTO Secretariat of any new version of the *OECD Arrangement*.

2. The identification of the "interest rate provisions" of the *OECD Arrangement*

34. Brazil also disagrees with the Canada – Aircraft panel (recourse to Article 21.5) on the question of what are the "interest rate provisions" of the arrangement[19] and claims that this only refers

[15] First written submission of Brazil, paragraphs 32 to 35.
[16] Paragraphs 36 to 39 and also paragraph 31.
[17] http://www.oecd.org/ech/act/xcred-en.htm
[18] Articles 2.4 and 5.4 TBT Agreement and Article 3.1 of the *SPS Agreement*.
[19] Paragraphs 34 to 50, contradicting notably paragraph 5.147 of the *Canada – Aircraft Article 21.5* panel Report

to the single provision in the main text and the Sectoral Understanding on Export Credits for Civil Aircraft that specify the minimum interest rates.[20]

35. The EC also disagrees with the view expressed by the above panel but for the opposite reasons. It considers that the *Canada – Aircraft* panel took too narrow a view of the "interest rate provisions" of the *OECD Arrangement.*

36. In particular, the EC submits that that panel failed to take adequately into account the fact that the *OECD Arrangement* is a non-binding instrument which is designed to provide a framework for transparency and fair competition in the field of export credit transactions between the participants and to be applied flexibly. The EC believes that a failure to take this circumstance into account leads to the terms of the *OECD Arrangement* and the scope of the safe haven being interpreted too narrowly. A notable consequence of this narrow interpretation is that the "matching" of supported rates, provided for in Article 29 of the *OECD Arrangement* would not be within the safe haven. The EC is firmly of the view that matching is in conformity with the *OECD Arrangement* and that the provisions that allow it are interest rate provisions and that therefore matching is covered by the second paragraph of item (k). Matching is specifically envisaged and authorised by the *Arrangement* but must comply with a strict set of conditions and procedures.[21]

37. Although the panel in the Canada – *Aircraft* case correctly gave a wide interpretation to the term "export credit practices"[22] which implies that that "interest rate buy downs" (that is interest rate equalisation) were covered by the second paragraph of item (k), it gave an excessively narrow interpretation to the "interest rate provisions" of the *OECD Arrangement.*[23]

38. The EC considers that it makes no sense to consider interest rates in isolation from all the conditions that influence the interest rate. That is why it considers that the reference to the "interest rate provisions" of the *OECD Arrangement* refers to all the provisions that may affect the interest rate – that is all provisions containing substantive rather than procedural obligations.

39. It is, in particular, completely unjustified to consider interest rates in isolation from the provisions relating to the *risk* involved and in particular the provisions on premiums.

40. Article 14 of the OECD *Arrangement,* which immediately precedes the definition of CIRR, contains a definition of interest that reads as follows:

> (c) interest excludes:
>
> any payment by way of premium or other charge for insuring or guaranteeing supplier credits or financial credits. Where official support is provided by means of direct

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[20] First written submission of Brazil, paragraph 40.

[21] The EC recognises that the *procedures* of the *OECD Arrangement* cannot be applied to non-participants. But this does not mean that non-participants would be disadvantaged. In fact the opposite is the case. The safe haven only require non-participants in the *OECD Arrangement* to apply in practice the interest rate provisions of the *OECD Arrangement*, which the EC believes means the substantive provisions which can affect interest rates and not the procedural provisions. Of course non-participants would not receive the notifications that participants receive but this should not stop them from matching an offer of export credit terms on a transaction that their companies are competing for. If a non-participant has doubts about the reliability of the alleged offer of non-Arrangement terms that it is invited to match, it may request confirmation of them from the offeror. Under the *OECD Arrangement* participants consider themselves entitled to match after they have taken appropriate measures to verify the terms (see e.g. Article 53). If non-participants are not required to follow the procedural requirements of the *OECD Arrangement*, they are nonetheless able to apply them by analogy.

[22] In paragraph 5.80 of the Report

[23] *Id.* paragraphs 5.80 – 5.92

credits/financing or refinancing, the premium either may be added to the face value of

Participants provide such insurance/guarantee in case of CIRR financing in order to minimise the potential cost for the budget of giving first class borrower rates to riskier countries/buyers.

49. One way of analysing PROEX III is to consider that it effectively compensates for the credit risk that would normally be charged to the borrower by the lending bank. As such it is equivalent to the payment of an insurance or guarantee payment and is an interest related official support for export credit that is not in conformity with these provisions of the *OECD Arrangement.*

50. The EC agrees with the statement of the Article 21.5 Panel in *Canada – Aircraft* that:[24]

> Thus, we conclude that full conformity with the "interest rates provisions" – in respect of "export credit practices" subject to the CIRR – must be judged on the basis not only of full conformity with the CIRR but in addition full adherence to the other rules of the *Arrangement* that operate to support or reinforce the minimum interest rate rule by limiting the generosity of the terms of official financing support.

51. The EC therefore disagrees with Brazil's statement in paragraph 52 of its first written submission that PROEX III conforms to "Articles 3 through 7 of the main text, and Articles 17 through 22 and Articles 24 and 25 of Annex IV."

C. THE FIRST PARAGRAPH OF ITEM (K)

52. The EC view on the first paragraph of item (k) is already known to the Panel.[25]

53. On the issue of "material advantage" it would appear that this is now being provided through the assumption of credit risk without remuneration.

IV. CONSULTATIONS IN ARTICLE 21.5 PROCEEDINGS

54. The EC has always maintained that consultations are an obligatory pre-condition to the establishment of a panel under Article 21.5 DSU. It repeats its position so as to make clear that it does not consent to what may be considered an evolving practice.

55. The first occasion when the question of whether consultations were required prior to the establishment of an Article 21.5 panel was in the context of the *Bananas* dispute. The EC made clear[26] that it considers consultations under Article 4 of the DSU to be necessary before the establishment of a panel can be requested under Article 21.5. The reason is the reference contained in Article 21.5 that any dispute on implementation "shall be decided through recourse to these dispute settlement procedures". In the view of the EC, "these dispute settlement procedures" include consultations and a right to an appeal. This is so for reasons related to the multilateral character of the procedures, which include procedural rights of other WTO Members, particularly potential third parties, and a standardised dispute settlement procedure the basic features of which may not be amended simply because that pleases the parties in an individual cases.

56. The EC considers that the obligatory requirements of the *DSU* can also not be modified by agreement between the parties.[27] If the parties to a dispute were entirely free to develop procedures of

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[24] Paragraph 5.114.

[25] First written submission of the EC to the original Article 21.5 panel, paragraphs 20 to 26 and oral statement, paragraphs 43 to 46.

[26] Cf. the statement of the EC representative at the DSB meeting of 22 September 1998, doc. WT/DSB/M/48, p. 7.

[27] The EC notes that there is no such agreement in the present case although there was such an agreement in the original Article 21.5 proceeding. A similar situation prevailed in the Article 21.5 proceeding concerning *Canada – Aircraft* and in the unfortunate and problematic case *Australia – Leather*, where the

their own choice (*quod non*), this would jeopardise third party rights enshrined in the *DSU* (particularly in Articles 4.11 and 10). Nothing would stop the parties from agreeing bilaterally not only to jump the procedural step of consultations, but also to jump other procedural steps such as the panel stage and to submit their dispute to the Appellate Body straight away (e.g. in order to "gain time" and to exclude third parties who cannot participate in Appellate Body procedures if they did not reserve their right to participate in the preceding panel procedure). It would also mean that the parties are free to agree among themselves that a panel report under Article 21.5 is not binding and that it may be subjected to some kind of review by another international body, such as the WHO in a case concerning human health considerations. It would, therefore, constitute circumvention, indeed, an undermining, of the system for dispute settlement established by the *DSU*.

57. The EC believes that these scenarios are not compatible with the multilateral nature of the procedures under the DSU, the procedural rights of third parties and indeed the general matrix of procedural checks and balances built into the DS system. The *DSU* contains sufficient flexibility to adapt the basic procedural requirements to the needs of the parties in individual disputes. As an example, Article 4.7 (second sentence) of the *DSU* allows the parties to shorten the 60-day period on the basis of a bilateral agreement. If the parties to the dispute agree, a panel under Article 21.5 of the DSU may be established at the first meeting where the request is considered by the DSB (Article 6.1 of the *DSU*). The panel may propose special working procedures after consultations with the parties (Article 12.1 of the *DSU*). All these provisions indicate that there is some flexibility in the procedures, which is largely dependent on the agreement of the parties to the dispute. None of these provisions however allows the parties to the dispute to simply omit one of the essential procedural steps before requesting the next one.

58. The procedural step of holding consultations is of fundamental importance for the dispute settlement system. Consultations give the parties an opportunity to resolve their differences without an adjudication of the dispute and will, at the very least, allow the parties to clarify on what precise issues their disagreement continues. In this way, consultations contribute to discharging panel proceedings from issues on which there is no real and serious disagreement. In addition, any request for consultations under Article 4 of the *DSU* must be circulated to the entire WTO membership in order to identify and circumscribe the dispute, thus allowing potential third parties to prepare their request to participate in the procedure. In this regard, it must be recalled that third parties may participate in consultations requested under any of the provisions cited in Article 4.11 and footnote 4 of the *DSU*. Thus, third party rights are clearly impaired by the omission of the formal consultation stage in a dispute settlement procedure.

59. All these important functions of the consultations are undermined if the parties to the dispute are considered to be free to "jump the gun" and go to a panel procedure without holding formal consultations under Article 4 of the *DSU* first. Moreover, consultations must anyhow take place in order to agree on the procedure to be followed, and it is obvious that this is also an occasion to consult

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parties agreed to dispense with Article 4 consultations as well as certain essential procedural guarantees such as an appeal (cf. doc. WT/DS126/8 of 4October 1999). In all these cases an explicit agreement was reached between the parties before the request for the establishment of a panel under Article 21.5 of the DSU was submitted to the DSB. In the dispute on *Australia-Salmon*, it appears that no formal consultations were held before Canada requested the establishment of a panel under Article 21.5 of the DSU. It appears moreover that the fact that the parties renounced their rights to formal consultations in that case was also the result of an agreement between the parties, but that agreement was not circulated to WTO Members (cf. doc. WT/DS18/14 of 3 August 1999).

Similarly, in the *Shrimp/turtle* case, an understanding was reached between Malaysia and the United States regarding possible proceedings under Articles 21 and 22 of the DSU (cf. doc. WT/DS58/16 of 12 January 2000). According to this agreement, Malaysia "will consult with the United States before requesting the establishment of a panel under Article 21.5". While it is not specified whether these consultations will be held under Article 4 of the DSU, no other relevant provision on consultations of the DSU would seem to be applicable.

on substantive issues. Thus, in reality no time is gained in jumping this procedural step, except that third parties are put at a disadvantage and that the panel may have to address issues on which there is no real disagreement.

ANNEX C-2

SUBMISSION OF KOREA AS A THIRD PARTY

(23 March 2001)

I. INTRODUCTION

1. Korea's interest in this DSU Article 21.5 proceeding is systemic. This has to do with the permissibility of an *a contrario* exception from the first paragraph of item (k) of the Illustrative List of Export Subsidies (the Illustrative List)[1].

2. Korea expresses no opinion about other issues and arguments raised by Canada and Brazil in this proceeding.

II. THE PERMISSIBILITY OF AN *A CONTRARIO* EXCEPTION

3. Under the first paragraph of item (k) of the Illustrative List, only those export credits that are used to secure a material advantage are categorized as prohibited export subsidies.

4. As a matter of logic, as well as of textual interpretation, then, an export credit practice that is not

expressly declared not to be prohibited export subsidies, but also practices that are prohibited export subsidies only where a specific condition (such as "secur[ing] material advantage") is satisfied.

8. The Appellate Body appears to share the position Korea takes. In its Article 21.5 report, it

ANNEX C-3

**SUBMISSION OF THE UNITED STATES
AS THIRD PARTY**

(23 March 2001)

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I. INTRODUCTION

1. The United States welcomes this opportunity to present its views in the second Article 21.5 proceeding requested by Canada to review Brazil's implementation of the Dispute Settlement Body's ("DSB") recommendations and rulings in *Brazil - Export Financing Programme for Aircraft*, WT/DS46/R, 14 April 1999 ("Panel Report"); WT/DS46/AB/R, 2 August 1999 ("Appellate Body Report").

2. Canada claims that the revisions made by Brazil on 6 December 2000 in respect of the *Programma de Financiamento às Exportações* ("PROEX") do not bring PROEX into conformity with the WTO Agreement on Subsidies and Countervailing Measures ("SCM Agreement") and the findings and recommendations of the Panel and the Appellate Body. Brazil argues in response that PROEX is not a subsidy under the SCM Agreement and that, even if it *is* a subsidy, it is not a prohibited subsidy. Due to the importance of various issues that the parties raise, the United States wishes to make certain brief observations that it hopes will assist the Panel in reaching its own determinations.

II. THE *A CONTRARIO* ISSUE

3. As it has in the past, Canada argues that the first paragraph of item (k) of the Illustrative List is not susceptible to an *a contrario* interpretation. Brazil disagrees with Canada's position. The United States has commented on this issue on numerous occasions over the course of these proceedings. For purposes of the present dispute, however, the United States takes no position on this issue other than to agree with Canada's statement that the second paragraph of item (k), footnote 59, item (h), and item (i) are all covered by footnote 5 of the SCM Agreement.[1]

III. THE RELEVANT *OECD ARRANGEMENT* REFERRED TO IN THE SECOND PARAGRAPH OF ITEM (K) IS THE VERSION OF THE *OECD ARRANGEMENT* IN EFFECT WHEN THE EXPORT CREDIT IS GRANTED

4. Brazil claims that the "relevant undertaking" referenced in the second paragraph of item (k) is limited to the version of the *OECD Arrangement* in effect on the date that the SCM Agreement entered into force (specifically, the 1992 version of the *Arrangement*). Brazil's argument is based on an erroneous interpretation of item (k). In the view of the United States, a proper textual analysis of the applicable language of item (k) demonstrates that the version of the *OECD Arrangement* in effect on the date that a Member grants the export credit at issue is the "relevant undertaking" with which the Member must comply.

5. The first sentence of the second paragraph of item (k) refers to "a successor undertaking which has been adopted by those original Members . . . ." Brazil claims that the term "has been" is central to a proper interpretation of this issue, on the grounds that the ordinary meaning of the term "has been" refers to a "'time regarded as present' when the text became effective on 1 January 1995."[2] In Brazil's view, the term "is a reference to a successor undertaking *already in existence* – an undertaking that '*has* been adopted."'[3] Brazil is mistaken.

6. The basis of Brazil's error is its belief that the term "has been" adopted refers to the time "regarded as present" when the text of item (k) became effective on 1 January 1995

relevant question for determining the availability of the safe harbor is whether, at the time a Member grants the export credit in question, it is doing so in conformity with the relevant provisions of the *Arrangement* then in effect. To paraphrase the second paragraph of item (k), if a Member is a party to the latest version of the *OECD Arrangement* that has been adopted, or if in practice a Member applies the interest rate provisions of that agreement, then an export credit practice which is in conformity with those provisions shall not be considered a prohibited export subsidy.

7. A contrary interpretation of this language would be 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 harbor in item (k). This would undermine the entire purpose of the safe harbor.

8. The drafting history of item (k) also demonstrates that Brazil's interpretation of this issue is mistaken. The final sentence of item (k) was inserted by the Tokyo Round negotiators of the

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normally incur in lending money. Reduced risk results in lower lending costs. Without the Member's payment, the exporter or financial institution would have to charge higher rates to cover the risk

C. EXPORT CREDIT GUARANTEES ARE COVERED BY THE SAFE HAVEN

17. A further consequence of the European Communities' position is that export credit guarantees are covered by the safe haven provided that they satisfy the conditions set out in Article 22 of the *OECD Arrangement* – one of which is that they are at rates "not inadequate to cover long term operating costs and losses." The European Communities draws the Panel's attention to the fact that Article 22 has integrated the conditions set out in item (j) of the Illustrative List in annex I to the *SCM Agreement* into the *OECD Arrangement.* It has also developed the conditions of item (j) by including other conditions, not found in item (j), within the *OECD Arrangement.*

D. MATCHING

18. The above considerations also lead to the conclusion that the "matching" provisions of the *OECD Arrangement* are also part of the "interest rate provisions". They also serve to "support and reinforce" the other interest rate provisions. The European Communities would refer the Panel to the comments it made in its written submission. [10]

19. The *Canada – Aircraft* panel did not share this view.[11] The textual basis for this conclusion appears very weak – the panel reasoned that matching – although allowed by the *OECD Arrangement* – could not be considered to be "in conformity" with it since matching was a "derogation". This is strained reasoning that ignores the informal and "gentleman's acovered r." T

required to follow the procedural requirements of the *OECD Arrangement*, they are nonetheless able to apply them by analogy.

IV. THE FIRST PARAGRAPH OF ITEM (K)

23. The European Communities did not discuss the first paragraph of item (k) in its written submission to the Panel, stating that it maintained its previously expressed views that were already known to the Panel from the previous proceeding.[14]

24. There appears to be one issue on which the European Communities has not stated its view – that of the kinds of measure that may fall under the first paragraph of item (k).

25. Whereas the second paragraph of item (k) covers all "export credit practices," a broad term, the scope of the first paragraph of item (k) is defined differently. It covers:

> The grant by governments … of export credits … or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits ….

26. Interest rate equalisation payments are not export credits. The only question is whether they can be "payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits."

27. The Panel was of the view in the first Article 21.5 proceeding that payments to a *lender* that amount to interest rate support cannot reasonably be understood to be payments of all or part of the costs of obtaining export credits.[15]

28. The Appellate Body considered that it did not need to consider this issue and that the Panel's findings on this issues were "moot, and, thus, of no legal effect.[16]

29. The European Communities considers that the interpretation of the first paragraph of Item (k) should not turn on who formally receives the payment or incurs the cost. Such an approach would allow circumvention of the disciplines. The purpose underlying both paragraphs of item (k) and the *OECD Arrangement* is to avoid distortions of competition arising out of export credit practices so that competition between exporters can relate to the other conditions they are being able to offer buyers. It is therefore the resulting attractiveness of the package for the buyer that is important – not the details of the payments between the various actors. A payment to one of these actors can reduce the burden on another – in other words be considered an indirect payment to that other.

V. CONCLUSION

30. The European Communities hopes that these remarks are helpful and wishes the Panel well in its consideration of the complex and difficult issues that are before it.

Thank you for your attention.

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[14] Written submission to the Panel, paragraph 52 referring to the first written submission of the European Communities to the original Article 21.5 panel, paragraphs 20 to 26 and oral statement, paragraphs 43 to 46.

[15] Article 21.5 Panel Report, paragraphs 6.71 to 6.73.

[16] Article 21.5 Appellate Body Report, paragraph 78.

ANNEX C-6

RESPONSES BY THE EUROPEAN COMMUNITIES TO QUESTIONS OF THE PANEL

(17 April 2001)

Q26. Please discuss your understanding of the meaning of the term "interest rate support" as used in Article 2 of the 1998 OECD Arrangement. Are PROEX III payments "interest rate support" within the meaning of the 1998 OECD Arrangement?

1. Article 2 of the *OECD Arrangement* starts by stating that it applies to all "official support" for exports with a term of two years or more. It then specifies the categories of measure covered. These are "direct credits/financing or refinancing, interest rate support, guarantee or insurance." It therefore appears that "interest rate support" is a residual category of "official support" for exports, that is, not in the form of direct credits/financing or refinancing or guarantees or insurance. It covers measures by which "official" bodies support interest rates without directly financing or refinancing transactions or providing guarantees or insurance.

2. PROEX III is a government (or "official") measure that allows the effective rate of interest for purchasers of certain Brazilian goods to be lower than it would otherwise be. It is therefore interest rate support within the meaning of Article 2.

Q27. Please discuss, how, if at all, the concept of minimum premium 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?

3. The EC explained in paragraph 49 of its written submission to the Panel and in paragraph 16 of its Oral Statement that it considered interest rate support in the form of an interest rate buy-down such as that provided by PROEX III to be the economic equivalent of a security or a guarantee.

4. According to Article 15 of the *OECD Arrangement*, CIRR corresponds to the interest rate payable by "first class" borrowers, that is, those for which the risk of non-repayment is the smallest. The interest rate that a borrower such as an airline must actually pay on financing will defend on the risk of non-repayment that the lender incurs and therefore on the security that is offered to guarantee repayment. Providing security involves a cost for the borrower. For example, if a borrower provides security in the form of a mortgage on its assets, it will be restricted in its freedom to use those assets and in particular to pledge those same assets to other lenders. If it provides the lender with a guarantee from a third party with better credit, such as a bank or the state, it will have to pay a premium for this guarantee and offer security or undertake obligations towards the guarantor.

5. In the field of both marketable and officially supported export credits three cost elements are charged to the borrower: the pure cost of money, the handling/administrative costs linked to the provision of financing and the cost of the risk of not being paid back by the debtor (see paragraph 43 of the EC written submission). Usually, the market charges an all-in rate covering those three cost elements, while the "officially suported sector" charges them separately (cf. Article 14c) of the 1998 OECD Arrangement). The CIRR rate (being government bond yields plus a 100/120 basis point margin) is deemed to cover the first two cost elements, whereas the minimuM premium is deemed to cover the third cost element (cf. Article 20 of the 1998 Arrangement).

6. Interest rate and premium, as well as their related disciplines, are complementary within the 1998 OECD Arrangement. Therefore, "interest rate support" is not identified in Article 20, devoted to

officially supported insurance/guarantee, just like insurance/guarantee is not identified in Article 15, devoted to officially supported financing. Direct credits/financing and refinancing are identified in both articles so as to avoid confusion because in those export credit techniques financing and insurance are mixed being specified that official support may be provided to only one part of the deal.

7. The fact that interest rate support is not expressly mentioned in Article 20 of the *OECD Arrangement* does not mean that it can be concluded that a practice such as PROEX III having the effect described above is consistent with the *OECD Arrangement.* The *OECD Arrangement* is described in the section "status" of the introduction as a "gentleman's agreement". One consequence of this is that circumvention of its provisions is not considered legitimate.

8. The benchmarks have not yet been published. If the Panel considers that the non-publication of the benchmarks is a reason why the minimum premia provisions cannot be considered part of the provisions that non-participants should apply "in practice" in order to benefit from the safe haven of the second paragraph of item (k), the EC would invite it to state this expressly so that it can be clear to all that once the benchmarks are published these provisions will be among those that non-participants must apply "in practice" in order to benefit from the safe haven.

ANNEX C-7

RESPONSES OF THE REPUBLIC OF KOREA TO QUESTIONS OF THE PANEL

(17 April 2001)

The Panel posed two questions to the third parties in this dispute. The responses of the Republic of Korea follow.

Q26. Please discuss your unders tanding of the meaning of the term "interest rate support" as used in Article 2 of the 1998 OECD Arrangement. Are PROEX III payments "interest rate support" within the meaning of the 1998 OECD Arrangement?

1. Article 2 of the 1998 OECD Arrangement deals with the scope of application of the Arrangement. It identifies five means by which official support for exports can be given – direct credits/financing, refinancing, interest rate support, guarantee or insurance. Korea believes that the Panel in the original recourse to Article 21.5 of the DSU in this dispute gave an accurate illustration of "interest rate support." At note 53 of its Report, the Panel stated:

> To take a hypothetical and highly simplified example, imagine that the yield on the relevant US Government bonds (and thus the US Government's cost of borrowing) is 5 per cent. Brazil's cost of borrowing is 10 per cent and the interest rate on commercial export credits is 8 per cent. Because it is constructed based on the relevant US Government bond yields plus 1 percentage point, the US dollar CIRR would be 6 per cent. While developed countries could afford to borrow at 5 per cent and provide export credits at 6 per cent, Brazil could only do so by providing direct export financing at 4 percentage points below its own cost of borrowing, an expensive proposition. It would be much less costly to Brazil to allow a commercial lender to provide the export credits, and pay the lender 2 percentage points in the form of interest rate support.[1] In other words, a government can provide either: (i) direct export credit financing; or (ii) interest rate support by buying down financing provided by a commercial lender (reducing the interest rates charged to the

Brazil-Export Financing Programme foroAircraft-Recour teeloCanada to Article 21.BTof the DSU

support" within the meaning of the 1998 OEC Korea fol61

> of default. In any event, these premia relate to the risk relating to the country of the *buyer/borrower*, not that of the *lender*.[2]

4. The Panel in Brazil's DSU Article 21.5 recourse regarding Canada's aircraft financing support also noted that the concept of minimum premiums does not apply to interest rate support:

> Moreover, we note that the *Arrangement* establishes explicit rules concerning guarantees and insurance, specifically by establishing minimum premium benchmarks. The minimum benchmarks are set with respect to adequacy of premiums to cover the "sovereign" and "country" credit risk involved in supported transactions. These benchmarks also apply explicitly to official financing support. Thus, both the minimum premium rule and the minimum interest rate rule on their faces make clear whether or not they apply to guarantees and insurance.[3]

5. Thus, interest rate support is not subject to the minimum premium provisions of Article 20 of the 1998 OECD Arrangement. Where a Participant provides interest rate support, unlike the other four types of support, the commercial lender, not the government, bears the risk of loss in the case of default. Thus, there is no need to ensure adequacy of premiums to cover the government's credit risk.

6. The Canadian Article 21.5 Panel Report also answers the third part of the Panel's Question 27 – minimum premium benchmarks are not available to non-Participants. As the Panel stated:

> We note that, by contrast, no information is published on the minimum premium benchmarks. Thus, only Participants have access to this information. Given this, it is at present impossible for a non-Participant to have any idea whether a given transaction respects the rules concerning minimum premiums. Thus, until such time as the Participants make this information publicly available, non-Participants should be presumed to be respecting the minimum premium rules in the context of any analysis under the second paragraph of item (k). Canada also has recognized this issue and come to the same conclusion. In particular, Canada states that "it would be unreasonable to expect a non-OECD WTO Member to charge a premium level whidg4raj 0 -1 36 - risri1596

ANNEX C-8

**RESPONSES OF THE UNITED STATES
TO QUESTIONS OF THE PANEL**

(18 April 2001)

For Third Parties

Q26. Please discuss your understanding of the meaning of the term "interest rate support" as used in Article 2 of the 1998 OECD Arrangement. Are PROEX III payments "interest rate support" within the meaning of the 1998 OECD Arrangement?

1. The term "interest rate support" as used in Article 2 of the 1998 *OECD Arrangement* refers to practices under which a government enters into an agreement on interest rates with a commercial bank that is providing the export credit financing for an export transaction. The purpose of the agreement is to allow the commercial bank to provide fixed rate financing at the appropriate CIRR rate. Commercial banks typically fund themselves on a floating interest rate basis such as LIBOR. In order for the bank to avoid losses associated with mismatched funding (i.e., funding itself at a floating rate and lending at a fixed rate), the government interest rate support provides the bank with a payment to compensate the bank for the funding risk. Typical of most OECD governments offering interest rate support, the government agrees that the commercial bank will receive a minimum return above its cost of funds to cover overhead and a normal profit margin on its services. On each semiannual repayment date under the loan, the difference between the bank's funding base plus the interest make-up margin and the CIRR rate is calculated. If the CIRR provides an interest rate that is lower than the commercial bank's funding rate plus the interest make-up margin, then the government pays the shortfall to the commercial bank. Thus, the interest rate support allows the commercial bank to offer CIRR financing without the interest rate risk associated with its funding at a floating rate. In addition, interest rate support allows commercial banks to help provide CIRR financing.

2. The United States is not sufficiently familiar with the facts of PROEX III to opine on whether PROEX III payments, as applied, constitute "interest rate support." As a general matter, the United States would consider interest rate support to be consistent with the *OECD Arrangement* if (a) the interest rate that the borrower sees after the interest rate support is the appropriate CIRR rate; and (b) the interest rate support is not offered in a manner or at a level that is used to cover other borrower costs associated with the transaction (such as the risk premium or the cost of the exported item).

Q27. 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 Arrangement available to non-Participants?

3. The minimum premiums reflected in Article 20 of the 1998 *OECD Arrangement* apply to all transactions in which a government provides support that shifts the repayment risk of the borrower from the lender to the government providing support. Interest rate support, in and of itself, does not shift the repayment risk of the borrower to the government providing the support because the government does not take on the risk of repayment. Hence, interest rate support is not mentioned in Article 20. Under Article 20, 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.

4. Virtually all of the information regarding the minimum premium benchmarks under the 1998 *OECD Arrangement* is available to non-Participants. This information is available on the OECD web

9. The *OECD Arrangement* itself also provides relevant context for resolving this issue. The purpose of the *OECD Arrangement* is:

> to provide a framework for the orderly use of officially supported export credits. The Arrangement seeks to encourage competition . . . based on quality and price of goods and services exported rather than on the most favorable officially supported terms.[2]

10. The premise of the item (k) safe harbor is that Members create a level playing field in the use of officially supported export credits by complying with the terms and conditions of the *Arrangement*. It would not be logical to read the second clause of the second pa Tma4huTj -4s. The

13. The Appellate Body has stated that "[t]he duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties."[5] The wording of the second paragraph of item (k) indicates an intention on the part of the drafters to create a limited safe harbor from the prohibition in the first paragraph of item (k) for Members who comply with the terms and conditions of the *OECD Arrangement.*

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[5] *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India*, WT/DS141/AB/R, Report of the Appellate Body at para. 83.