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Regional Jet Trade Wars: Politics and Compliance in WTO Dispute Resolution

Helena D. Sullivan¹

INTRODUCTION

The Dispute Settlement Understanding (DSU),² part of the Uruguay Round, has taken a new approach to resolution of conflicts between World Trade Organization (WTO) member states. This new approach is much like the traditional national systems, which are intended to have a binding effect. The authority of such a system depends on members setting aside political considerations, such as DSU cases naturally engender, to respect their WTO obligations. Theoretically, all members of the WTO would benefit from such a binding arrangement to resolve conflicts.

In the history of the Dispute Settlement Body (DSB), there have been several major challenges to the authority of the new dispute settlement system. These disputes between the United States and the European Union over bananas,³ hormone-treated beef,⁴ and the U.S. Foreign Sales Corporation Tax Regime have attracted considerable attention.⁵ Disputes between these WTO “heavy hitters” have already come close to testing the authority

1. Judicial Law Clerk, United States Court of International Trade; LL.M. (International Legal Studies), New York University School of Law; LL.B., University of Alberta Faculty of Law.

2. GATT Secretariat, *General Agreement on Tariffs and Trade: Multilateral Trade Negotiations Final Act Embodying the Results of the Uruguay Round of Trade Negotiations*, 33 I.L.M. 1125 (1994), available at http://www.wto.org/English/docs/legal_e/final_e.htm (last visited Oct. 10, 2002) [hereinafter Final Act].

3. WTO Appellate Body Report, *European Communities Regime for the Importation, Sale, and Distribution of Bananas*, WT/DS27/AB/R, 37 I.L.M. 243 (1998), available at www.wto.org (last visited Nov. 1, 2002).

4. WTO Arbitration Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/ARB, 37 I.L.M. 1246 (1998), available at www.wto.org (last visited Nov. 1, 2002).

5. WTO Appellate Body Report, *United States – Tax Treatment for “Foreign Sales Corporations,”* WT/DS108/AB/R, 39 I.L.M. 717 (2000), available at www.wto.org (last visited Nov. 1, 2002).

of the system, as member states have essentially refused to subvert domestic political considerations to WTO rulings.⁶ However, lurking deep in the headlines of local newspapers is a bitter dispute between Canada and Brazil regarding subsidies for regional jet aircraft manufacturers.⁷ Although the Canada/Brazil jet subsidies dispute is lesser known, it may create implications for the WTO that reach far beyond the effects on these two countries.

The jet subsidies dispute illustrates several complications with the WTO's new approach to conflict resolution, adopted in 1994.⁸ This dispute is a prime example of the tension that WTO dispute settlement can produce between developed and developing member states. In Brazil's view, the Canadian complaint brought against Brazil in the WTO presents a serious threat to its aspiration to become a First World nation.⁹ Additionally, the case reveals potential problems with the calculations of countermeasures because the stated intention of such retaliatory measures is not to punish or to compensate, but to induce compliance.¹⁰ So far, the countermeasures have not been successful in this role.¹¹ This case may also force the WTO to confront the thorny question of whether the DSU was meant to provide a truly binding system.

This article will recount how a typical dispute over subsidies evolves into a conflict that may have potential repercussions for many industries and set a dangerous precedent of non-compliance with Panel and Appellate Body rulings. Part I will explain the dispute between Canada and Brazil and the new mechanism for dispute resolution. Part II will review the Panel and Appellate Body decisions made in this dispute. Part III will detail the evolution of a trade war between Canada and Brazil. Part IV will analyze the issues raised by this dispute and suggest possible solutions.

6. See Benjamin L. Brimeyer, *Bananas, Beef and Compliance in the World Trade Organization: The Inability of the WTO Dispute Settlement Process to Achieve Compliance from Superpower Nations*, 10 MINN. J. GLOBAL TRADE 133 (2001).

7. *Id.*

8. See Andreas F. Lowenfeld, *Remedies Along with Rights: Institutional Reform in the New GATT*, 88 AM. J. INT'L L. 477 (1994).

9. Mark MacKinnon, *Brazil Has Much at Stake in Jet Dogfight*, GLOBE AND MAIL (Toronto), Feb. 3, 2001, at B1.

10. Final Act, *supra* note 2, at 1239.

11. See discussion *infra* Part II.B.

I. REGIONAL JET SUBSIDY DISPUTE

Article 3.2 of the DSU states that the central element of the WTO dispute settlement system is "providing security and predictability to the multilateral trading system."¹² If both Canada and Brazil defy the system, that security and predictability may be undermined. The series of decisions by the panel, Appellate Body, and Arbitration Panel, largely in Canada's favor, included some of the most significant determinations in the history of the DSU on retaliatory measures.¹³ However, these rulings have done little to resolve the trade problems between the two countries. Instead, recent events, including outrage, accusations of pretextual retaliation, and threats by Brazil over a controversial Canadian ban on beef imported from Brazil on "mad cow disease" grounds,¹⁴ only seem to suggest that the situation is escalating.

A. THE NEW MECHANISM FOR DISPUTE RESOLUTION

Under the DSU, the preferred method of resolution of a GATT dispute is still termination of the offending measure.¹⁵ However, the DSU has new "teeth." If termination does not happen, the DSU requires the offending member state to inform the DSB, within thirty days of the adoption of the report, of the member state's intention with regard to the offending measure.¹⁶ The member state has a reasonable period to comply, but what is reasonable is now subject to DSB scrutiny¹⁷. The DSB then closely examines the offending member state's implementation of its recommendation. If the offending measure is not removed within a reasonable period, there are several options.¹⁸ First, the offending state may negotiate with the complaining state for

12. Final Act, *supra* note 2, at 1227.

13. MacKinnon, *supra* note 9.

14. Mark MacKinnon, *Health Canada Suspends Scientist*, GLOBE AND MAIL (Toronto), Feb. 21, 2001, at A5.

15. Final Act, *supra* note 2, at 1227-28. Article 3.8 of the DSU states that for breach of the covered agreements, there is a presumption of nullification or impairment of benefits, so that the party in breach bears the burden of proof. *Id.* If a measure has been found to be in breach, Article 3.7 of the DSU states that when withdrawal of the measure is the first objective of the dispute settlement mechanism, compensation should be resorted to only if immediate withdrawal is impracticable. *Id.*

16. *Id.* at art. 21.3, at 1238.

17. *Id.* at arts. 21.6, 21.22, at 1239-41 (stating that DSB approval, agreement between the parties, or binding arbitration is required).

18. *Id.*

mutually acceptable compensation.¹⁹ Second, the complaining party, with DSB, approval may retaliate by suspending concessions or other obligations.²⁰ Suspension of concessions is only used as a last resort because of the trade-distorting impact the suspensions have. Moreover, the retaliation must be equivalent to the level of impairment or nullification of benefits, and if possible, should be directed to the same industry as the one involved in the original complaint.²¹ If the offending state objects to the level of retaliation, the parties must arbitrate before the original panel, if it can be reassembled.²² Nevertheless, such retaliation must cease if the offending measure is removed or otherwise resolved, as the DSU makes it clear that the system is not punitive. In the dispute over jet subsidies, however, the success of the DSB in inducing compliance must be evaluated in the context of Brazil's desire to advance beyond 'developing country' status.

B. THE DISPUTE HEATS UP

The market for regional jet aircraft has been robust in the last decade, creating tension between Canada and Brazil as they compete in this lucrative market. Between 1970 and 1998, the number of passengers on regional jets grew at an average annual rate of 11.5 percent.²³ In 1998, about 200 million passengers were transported on regional jets, an over \$8 billion (U.S.) a year industry.²⁴ Airlines have increasingly been replacing turbo prop aircraft with regional jets, which now comprise more than eighty percent of the orders for new aircraft.²⁵ Two of the major players in the regional aircraft industry are Canada's Bombardier and Brazil's Embraer.²⁶ By 1999, Embraer had an annual gross revenue of \$1.8 billion (U.S.), which was a 405 percent in-

19. Final Act, *supra* note 2, at art. 22.2.

20. *Id.*

21. If impossible, it should be extended to other sectors covered by the same agreement. *Id.* If that is impractical, then it may be extended to sectors covered by another agreement. *Id.* at art. 22.3, at 1239-40.

22. *Id.* at art. 22.6, at 1240. There is a deadline of sixty days from the expiration of the reasonable period. *Id.*

23. Bombardier Aerospace Regional Market Outlook 1999, SpeedNews Aircraft Fleets and Statistics, available at <http://www.speednews.com/lists/lists.shtml> (last visited Oct. 7, 2002).

24. *Id.*

25. *Id.*

26. MacKinnon, *supra* note 9.

crease over its 1995 revenue of \$356 million (U.S.).²⁷ By 1999, Bombardier had 17.3 of the U.S. regional lift capacity with its "Regional Jet," followed by the Embraer ERJ 145 with 12.6 percent.²⁸ Despite its problems with Canada, Embraer's revenue has continued to increase, with the 2000 Embraer Annual Report²⁹ showing revenue of \$2.859 billion (U.S.) to Bombardier's 2000 revenue of \$13.6 billion (U.S.), \$8.1 billion (U.S.) of which resulted from aerospace.³⁰

To gain insight into the importance of the aerospace industry to Brazil, it is desirable to understand Sao Jose dos Campos, an area northeast of Sao Paulo, which has been described as the "Silicon Valley of Brazil."³¹ This area is far more prosperous than other Brazilian centers and wages in this city are high by Brazilian standards.³² San Jose dos Campos' business center is Embraer SA with about 10,000 employees of its own. Since privatizing in 1994, it has become the largest exporter in Brazil and the world's fourth largest commercial airplane producer.³³ Embraer has a strategic role in Brazil's defense system, with over fifty percent of the Brazilian Air Force fleet using Embraer products.³⁴ Embraer also focuses on the regional jet market with customers such as Air France, American Airlines, and Swissair.³⁵ Embraer is second only to Canada's Bombardier in the regional jet market.³⁶ To Brazilians, Embraer is more than a corporation, it is a symbol of Brazilian success in a "First World" industry, thus representing their hopes for the future.³⁷

27. Brazil Economic Brief No. 01-2000, available at <http://www.brasilemb.org/beb/BIB%201%20-%20January202000.html> (last visited Oct. 7, 2002) and <http://www.financialpost.com/demos/FPCPdemo/C3Itemb.htm> (last visited Oct. 10, 2002). Bombardier, which has other divisions in addition to aerospace, had 1999 operating revenues of \$11.5 billion (Can.), \$6.4 billion of which was related to aerospace. *Id.*

28. Regional Airline Association, Regional Airlines Achieve Impressive Growth in 2000, Table 3, at <http://www.raa.org/newsdesk/2000yrdend.htm> (last visited Oct. 10, 2002).

29. Embraer, Annual Report 2000, at <http://www.embraer.com> (last visited Oct. 10, 2002).

30. Bombardier, Annual Report Year Ended January 31, 2001, available at <http://www.bombardier.com> (last visited Oct. 10, 2002).

31. MacKinnon, *supra* note 9.

32. *Id.*

33. *Id.*

34. Larry Rohter, *Brazil's Hot Commodity? Not Coffee or Soccer*, N.Y. TIMES, Dec. 31, 2000, § 3, at 1.

35. MacKinnon, *supra* note 9.

36. *Id.*; Heather Scoffield, *Bombardier-Embraer Dogfight Heats Up*, GLOBE AND MAIL (Toronto), Feb. 15, 1999, at B1; MacKinnon, *supra* note 9.

37. Brazil's top trade negotiators have often spoken of their hopes for industry

Competition between Embraer and Bombardier is strong. With its lower labor costs, Embraer is taking over Bombardier's customer base.³⁸ Even InterCanadian Airlines ordered six of Embraer's ERJ-145 jets.³⁹ This deal resulted in controversy when Onex, a merger partner of Air Canada and InterCanadian, called the deal misguided and stated publicly that InterCanadian should have opted for Bombardier's products.⁴⁰ Onex claimed that InterCanadian had only agreed to buy the Embraer planes after being offered very generous financing terms through Brazil's PROEX program.⁴¹

These generous financing terms were made possible by PROEX, a program that Brazil established in 1991.⁴² This program offers below market rate loans to buyers of Brazilian exports.⁴³ The Bank of Brazil, which administers PROEX, which makes "interest rate equalization" payments and sets the financing conditions by ministerial decree.⁴⁴ The lending bank receives payments in the form of bonds from the Brazilian government, redeemable only in Brazil and in Brazilian currency.⁴⁵ In the case of regional jets, the term of these payments may, and often is, extended to fifteen years.⁴⁶ This reduces the cost of the aircraft overall.

In 1998, at the urging of Bombardier and Canadian businesses, Canada challenged Brazilian support for Embraer in the DSB, seeking a WTO Panel ruling on the Brazilian export subsidies.⁴⁷ Brazil argued, however, that Canada was mistaken in

expansion in technologically sophisticated goods. Scoffield, *supra* note 36.

38. MacKinnon, *supra* note 9.

39. *Onex Would Push to Scrap Embraer Canada Deal*, MONEY, Nov. 2, 1999, at http://allpop.com/AirMergers/nov2_aircanonexe.mbr.html.

40. *Id.*

41. *Id.*

42. WTO Dispute Panel, *Brazil - Export Financing Programme for Aircraft*, WT/DS46/R (Apr. 14, 1999), paras. 2.1-2.6, available at <http://www.wto.org> [hereinafter WT/DS46/R].

43. *Id.*

44. *Id.*

45. *Id.* para. 4.115.

46. *Id.*

47. Canada originally requested consultations in the WTO on June 21, 1996. *Id.* However, Canada did not pursue the matter vigorously until July 13, 1998, when it announced that it would seek a WTO Panel ruling on the Brazilian export subsidies. DEPT OF FOREIGN AFFAIRS AND INT'L TRADE, DISPUTE SETTLEMENT PANEL CASES TO WHICH CANADA IS A PARTY, available at <http://www.dfait-maeci.gc.ca/tna-nac/dispute-e.asp> (last visited Oct. 10, 2002). See also Panel Report, *Brazil - Export Financing Programme for Aircraft*, WT/DS46/5, (July. 13, 1998), available at <http://www.wto.org> [hereinafter WT/DS46/5].

its belief that PROEX payments were made to the purchaser.⁴⁸ Instead, they argued payments were actually being made to the lender to offset the costs it incurred in obtaining internationally competitive rates.⁴⁹ From a Brazilian perspective, PROEX merely creates a level playing field since interest rates in Brazil are in the fifteen percent range.⁵⁰ Additionally, Brazil cited "Brazil Risk" as an added cost which PROEX was designed to equalize.⁵¹ A guarantee on a loan to a financially risky regional airline guaranteed by Canada had the security of Canada's sovereign risk, whereas the same loan guaranteed by Brazil had a sovereign risk 1,000 basis points or ten percentage points above Canada's.⁵² Brazil then went on the counteroffensive by requesting a panel and by challenging a variety of Canadian measures as inconsistent with WTO rules.⁵³ Brazil's complaint alleged that Canada's Bombardier had been supported by a variety of GATT-illegal subsidy programs.⁵⁴

II. THE PANELS AND APPELLATE BODY EXAMINE THE SUBSIDY PROGRAMS

A. DISPUTE SETTLEMENT

On April 14, 1999, the WTO released two relevant Panel Reports.⁵⁵ The Panel hearing the challenge to the Embraer subsidies ruled in Canada's favor on eight of ten points in the challenge to the Brazilian program.⁵⁶ It declared PROEX an illegal export subsidy and required that it be withdrawn without de-

48. WTO Appellate Body, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (Aug. 2, 1999), reprinted in 4 INT'L TRADE REP. 9 (2000), available at <http://www.wto.org> and 1999 WL 591866 [hereinafter WT/DS70/AB/R].

49. *Id.*

50. MacKinnon, *supra* note 9; see also WT/DS46/R, *supra* note 42.

51. The term "Brazil Risk" refers to the idea that the credit rating of the country guaranteeing the loan is very important, as it would affect the terms of the loan granted by the lender. MacKinnon, *supra* note 9.

52. *Id.*

53. Originally, consultations were requested in WTO Dispute Panel, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/1 and WT/DS71/1 (Mar. 14, 1997), available at <http://www.wto.org>. The first request for a panel did not come until 1998, in WTO Dispute Panel, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/2 (July 13, 1998), available at <http://www.wto.org> (last visited Oct. 10, 2002) [hereinafter WT/DS70/2].

54. WT/DS70/2, *supra* note 53.

55. *Id.*

56. WT/DS46/R, *supra* note 42.

lay.⁵⁷ The Panel based their finding on the Agreement on Subsidies and Countervailing Measures (SCM Agreement).⁵⁸ Article 3 of the SCM Agreement prohibits subsidies contingent on export performance, including those illustrated in Annex I, which is referred to as the Illustrative List.⁵⁹ The Panel found that PROEX constituted a subsidy program targeted at export performance, within the meaning of Article 3.1(a) of the SCM Agreement and, therefore, violated Article 3 of SCM Agreement.⁶⁰ The Panel, however, declined to make a recommendation on implementation as requested by Canada, stating that such a specific recommendation was not within its role, but held that the offending measure had to be withdrawn within ninety days.⁶¹

Canada argued that the “Brazil Risk” argument was fallacious since most of the lending institutions involved in the Embraer transactions were outside of Brazil and the PROEX payments were reducing interest rates below international market rates.⁶² Brazil countered with the argument that most of the transactions involved lenders inside Brazil, and that even when lenders were outside Brazil, the exporters still bore “Brazil Risk.”⁶³ Furthermore, Brazil argued that Embraer’s cost of obtaining credit for its customers outside Brazil from non-Brazilian institutions reflected “Brazil Risk.”⁶⁴

The Panel, noting that the structure of PROEX allowed the purchaser complete freedom to obtain financing wherever he chose, found that Brazil had submitted no evidence to demonstrate that PROEX did not allow the purchaser to negotiate terms more favorable than would otherwise have been available.⁶⁵ Therefore, PROEX payments were “used to secure a material advantage.”⁶⁶ The Panel rejected Brazil’s argument that PROEX should be permitted because this measure does not fit the specifications of paragraph one of item (k) of the Illustrative List.⁶⁷ This section provides:

57. *Id.*

58. Final Act, *supra* note 2, at Annex 1A.

59. WT/DS46/R, *supra* note 42, paras. 7.113-7.37.

60. *Id.* paras. 8.1-8.2.

61. *Id.* para. 8.5.

62. *Id.* paras. 4.128-4.143.

63. *Id.* para. 4.137.

64. *Id.*

65. WT/DS46/R, *supra* note 42, paras. 7.36-7.37.

66. *Id.* para. 7.37.

67. *Id.* paras. 7.113-7.37.

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

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 original 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.⁶⁸

This unsuccessful argument was referred to as the *a contrario* argument – the theory being that any subsidy measure that was not within the parameters of the first paragraph of item (k) must therefore be permitted.⁶⁹ However, the Panel ruled that while it was not clear to them whether a particular list of subsidies was permissible, PROEX was not used to secure a material advantage in the field of export credit terms, so Brazil could not use the item (k) defense.⁷⁰ The Panel further found that the presumption of nullification or impairment of benefits under Article 3.8 of the DSU had not been rebutted by Brazil.⁷¹

The Panel also found that PROEX did not fit within the exception for developing countries in Article 27 of the SCM Agreement.⁷² The Panel examined the issue of whether Article 27 of the SCM Agreement, which addresses developing country needs, exempted Brazil from SCM Agreement Article 3.1(a).⁷³ Article 27.2(b) provides that the prohibition of Article 3.1(a) does not apply to “other developing country Members for a period of eight years from the date of entry into force of the WTO Agreement, subject to compliance with the provisions of paragraph 4.”⁷⁴ Article 27.4 provides:

Any developing country Member referred to in paragraph 2(b) shall

68. Final Act, *supra* note 2 (emphasis added).

69. WT/DS46/R, *supra* note 42, paras. 7.35-7.5.

70. *Id.*

71. *Id.* para. 8.3.

72. See *infra* note 115 and accompanying text.

73. See *infra* note 115 and accompanying text.

74. Final Act, *supra* note 2, at Annex 1A.

phase out its export subsidies within the eight-year period, preferably in a progressive manner. However, a developing country Member shall not increase the level of its export subsidies, and shall eliminate them within a period shorter than that provided for in this paragraph when the use of such export subsidies is inconsistent with its development needs[.]⁷⁵

The Panel found that Canada had the burden of proof of establishing the applicability of Article 3 of the SCM Agreement and the non-applicability of Article 27.4 to Brazil.⁷⁶ The Panel found that Brazil had not only failed to phase out its export subsidies as required by Article 27, but had actually increased them.⁷⁷ In making this finding, the Panel held again that actual, rather than budgeted, amounts were the relevant figures to examine regarding the level of subsidy.⁷⁸ The Panel rejected Brazil's argument that 1991, the date of creation of the PROEX program, was the appropriate benchmark date and not 1994, the date immediately preceding the enactment of the SCM Agreement.⁷⁹ The reason that Brazil made this argument was that the level of subsidies alleged by Canada was below 1991 levels.⁸⁰ The Panel held that though Canada had failed to establish that the export subsidies were inconsistent with Brazil's developmental needs, Brazil's failure to institute a subsidy phase-out and the increase in subsidy levels meant that these subsidies did not fall within the SCM Agreement Article 27 exception for developing countries.⁸¹

Concurrently, a separate panel looked at Brazil's challenges to the Canadian measures.⁸² The panel found that the Canada Account program of debt financing for regional aircraft since 1995 and the Technology Partnerships Canada (TPC) assistance to the regional aircraft industry violated Article 3 of the SCM Agreement.⁸³ Canada Account was a program administered by Economic Development Canada (EDC) to support export transactions that the federal government deemed to be in the national interest, but which, for reasons of size or risk, could not

75. *Id.* at art. 27.4.

76. *Id.* See also WT/DS46/R, *supra* note 42, para. 7.57.

77. WT/DS46/R, *supra* note 42, paras. 7.58-7.85.

78. *Id.* para. 7.74.

79. *Id.* para. 7.61.

80. *Id.* para. 7.63.

81. *Id.* paras. 7.83-7.85, 7.87-7.93.

82. WT/DS70/AB/R, *supra* note 48.

83. WT/DS46/R, *supra* note 42, paras. 9.158-9.203. The TPC assistance included an \$87 million investment in Bombardier for its seventy seat CRJ project in which TPC was to get a mere 1.76 percent return. *Id.* paras. 9.158-9.203.

be supported by normal export credits.⁸⁴ The Panel rejected Canada's contention that "advantage" was not to be given its ordinary meaning, finding that the benchmark should be the cost to government.⁸⁵ However, a number of other Canadian programs challenged by Brazil were found not to be in violation of WTO obligations.⁸⁶ Canada appealed that Panel ruling on May 3, 1999,⁸⁷ and Brazil filed its own notice of appeal on the same date.⁸⁸

The Appellate Body affirmed the Panel's ruling regarding Brazilian aircraft subsidies on August 2, 1999, as well as the Panel ruling that the subsidy program must be withdrawn within ninety days of the adoption of the Reports.⁸⁹ The Appellate Body found that there had been a violation of Section 3.1(a) of the SCM Agreement, that the Panel correctly held that the complaining party had the burden of showing that Brazil did not fall within the Article 27 exception, Canada had met its burden, and therefore Article 3.1 applied.⁹⁰ However, the Appellate Body stated that the Panel was incorrect in its analysis of the relevance of when the export subsidies had been granted.⁹¹ The timeline surrounding the granting of the export subsidies was only relevant to discover whether the level of subsidies had been varied, in order to determine whether the Article 27 developing country exception applied.⁹² The Appellate Body also ruled that the proper point of reference was actual expenditures, not budgeted amounts, that constant dollars rather than nominal dollars

84. WT/DS70/AB/R, *supra* note 48.

85. WT/DS46/R, *supra* note 42, para. 9.312.

86. These included Economic Development Canada (EDC), which Brazil argued was prohibited since it gave higher-risk debt financing and did not collect a risk premium, the Societe de Developpement Industriel du Quebec, and the Canada-Quebec Subsidiary Agreements on Industrial Development. The Panel also rejected a challenge to the sale by Ontario Aerospace Corporation to Bombardier of forty-nine percent of the shares of de Havilland. De Havilland was an established leader in the regional aircraft industry, and has delivered over 7,400 Twin Otter, Dash 7 and Dash 8 turboprop aircraft in its history. See Bombardier - History, at http://www.aerospace.bombardier.com/htmen/10_0.htm (last visited Oct. 8, 2002).

87. WTO Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/4 (May 3, 1999), available at <http://www.wto.org>.

88. WTO Appellate Body Report, *Brazil - Export Financing Programme for Aircraft*, WT/DS46/8 (May 3, 1999), available at <http://www.wto.org>.

89. WTO Appellate Body Report, *Brazil - Export Financing Programme for Aircraft*, WT/DS46/AB/R, 38 I.L.M. 1708, (Aug. 2, 1999), available at <http://www.wto.org> [hereinafter WT/DS46/AB/R].

90. *Id.* para. 196(b).

91. *Id.* paras. 154-59.

92. *Id.* paras. 147-49.

were to be used in the calculation, and that the subsidies were granted when the bonds were actually issued, not when the letter of commitment was issued.⁹³ The Appellate Body declined to rule on whether the failure to secure a material advantage under the first paragraph of item (k) of the Illustrative List meant a measure was permitted, stating that the issue was whether there has been a material advantage in the field of export credit terms.⁹⁴

The Appellate Body also found that the Panel had erred in its definition of “material advantage.”⁹⁵ Since the marketplace was considered a relevant benchmark, the second paragraph of item (k) of the Illustrative List, which makes reference to agreements such as the OECD Arrangement,⁹⁶ was useful as a guide in determining whether there had been a material advantage secured.⁹⁷ Rather than simply being equivalent to a benefit under SCM Agreement Article 1.1, the Appellate Body held that “material advantage” is the difference between the actual rate of interest paid after deduction of the government payment and the Commercial Interest Reference Rate (CIRR) supplied by the OECD Arrangement.⁹⁸

The Appellate Body ruled that PROEX did indeed confer such an advantage, stating that while it recognized that the OECD Arrangement did in some circumstances allow “matching” of rates to programs of other governments, resulting in

93. *Id.* para. 196.

94. *Id.* paras. 143, 147-59.

95. WT/DS46/AB/R, *supra* note 89, paras. 179-81.

96. This refers to the Organization for Economic Cooperation and Development (OECD) *Arrangement on Guidelines for Officially Supported Export Credits*, which places limitations on the terms and conditions of export credits that benefit export support. Its purpose is to provide an institutional framework for an orderly market for officially supported export credits. It therefore seeks to prevent an “export credit race” where exporters compete to grant the most favorable subsidy from their respective governments. There are minimum repayment terms, a minimum cash-down payment, and countries are classified under two categories in which classification is tied to GNP. Minimum interest rates that may benefit from official financing support are referenced as Commercial Interest Reference Rate (CIRR). They have been established for twelve currencies, the majority of which are based upon either the 5-year Government bond yields or on 3, 5, and 7-year bond yields, according to the length of the repayment period. Each member may select the basis for its own CIRR. CIRR’s are adjusted monthly and are intended to reflect commercial interest rates. Roland P. Wiederaenders, III, *Export Financing Options for NAFTA Country Businesses*, NAFTA: Law and Business Review of the Americas, 4 NAFTA: L. & BUS. REV. AM. 51, 53-54 (1998); see also <http://www.oecd.org/EN/home0,,EN-home-0-nodirectorate-no-no-no-0,FF.html> (last visited Oct. 9, 2002).

97. WT/DS46/AB/R, *supra* note 89, paras. 181-82.

98. *Id.* para. 181.

rates below the CIRR rates, that exception was not applicable in this case.⁹⁹ Comparison between net interest rates applied as a result of a subsidy program and the total amount of subsidies granted by another member was not allowed by the provisions of the OECD Arrangement.¹⁰⁰ Further, the Appellate Body noted that interest rate equalization subsidies were provided at an across-the-board rate of 3.8 percent for PROEX and did not vary according to the subsidies being provided by the other member state it was allegedly matching.¹⁰¹ While this argument was therefore unsuccessful, the Appellate Body stopped short of a statement that such matching would never be permissible.¹⁰² Nevertheless, the Brazilian argument that it should be allowed to offset all of the Canadian subsidies for Bombardier in the calculation of the subsidy of PROEX was rejected.¹⁰³

Brazil vigorously pursued its own claims in the Appellate Body, cross-appealing issues regarding the EDC, the Canada Account, and the TPC. In Brazil's claim against Canada, the Appellate Body found that Canada's TPC program was not GATT-compliant.¹⁰⁴ It based this decision on the finding that, consistent with other decisions, the definition of "subsidy" in Section 1.1(b) of the SCM Agreement, which refers to conferring a benefit, means a benefit to the recipient.¹⁰⁵ The yardstick for making this determination was held to be the marketplace rate, not the cost to government.¹⁰⁶ The Appellate Body stated that whether a subsidy was export-contingent was dependent upon the facts, and the facts that must be taken into account vary according to circumstances.¹⁰⁷

The EDC provided billions of dollars in loans annually to Canadian companies selling abroad.¹⁰⁸ The Appellate Body stated that the Panel was correct to reject the allegations against EDC, as the Panel did not have enough evidence to support the Brazilian position that EDC offered lower than market rate illegal loans.¹⁰⁹ The Appellate Body held that the Panel did

99. *Id.* para. 185.

100. *Id.*

101. *Id.*

102. *Id.*

103. WT/DS46/AB/R, *supra* note 89, para. 185.

104. WT/DS70/AB/R, *supra* note 48.

105. *Id.*

106. *Id.* paras. 217-19.

107. *Id.* para. 169.

108. *Id.* para. 181 (citing WT/DS70/AB/R, *supra* note 48, para. 9.181).

109. *Id.* paras. 214-16.

not err or abuse its discretion in refusing to draw adverse inferences from Canada's refusal to provide information regarding certain EDC debt financing, but stated that it might have decided differently had the matter been before it.¹¹⁰ The Appellate Body disapproved of the Canadian lack of transparency and emphasized that Brazil could certainly bring a further DSB proceeding and request further information under Article 25.8 of the SCM Agreement.¹¹¹ Canada was required to provide this information under Article 25.9 in order to allow Brazil to assess compliance with SCM Agreement obligations.¹¹² The Appellate Body refused to "solicit, receive or review new facts," stating that they could not do so under Article 17.6 of the DSU.¹¹³ Then in special session on August 20, 1999, the DSB adopted the decisions of the Appellate Body.¹¹⁴

B. THE ILLUSION OF COMPLIANCE

In November 1999, Canada announced that it had fully complied with the ruling regarding its own subsidy programs and that it would ask the WTO to determine whether Brazil had fully implemented the ruling and withdrawn the prohibited subsidies.¹¹⁵ Brazil announced it was proceeding with its own compliance challenge.¹¹⁶ Article 21.5 of the DSU provides that if there is a dispute regarding compliance, it is to be referred, when possible, to the original panel, which must give a ruling within ninety days of the referral.¹¹⁷

On May 9, 2000, the reconstituted Panel found that Brazil failed to remove the export subsidies and that changes it made to PROEX were vastly inadequate. The Panel criticized the failure of Brazil to do anything about PROEX support (PROEX bonds) for future aircraft deliveries under contracts made before

110. WT/DS70/AB/R, *supra* note 48, para. 205.

111. *Id.*

112. *Id.*

113. *Id.* para. 206.

114. WTO Appellate Body Dispute Panel, *Brazil - Export Financing Programme for Aircraft*, WTO/DS46/10 (Sept. 6, 1999), reprinted in 2 INT'L TRADE REP. 8 (2000), available at <http://www.wto.org> (last visited Oct. 10, 2002) and 1999 WL 688121.

115. WTO Dispute Panel, *Brazil - Export Financing Programme for Aircraft*, WT/DS46/13 (Nov. 26, 1999) reprinted in 4 INT'L TRADE REP. 8, para. 1.3 (2000), available at <http://www.wto.org> [hereinafter WT/DS46/13].

116. WTO Dispute Panel, *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/9 (Nov. 29, 1999), reprinted in 4 INT'L TRADE REP. 8, para. 1.3 (2000), available at <http://www.wto.org>.

117. Final Act, *supra* note 2.

the November 18, 1999 implementation deadline.¹¹⁸ There were more than 900 of these undelivered aircraft.¹¹⁹ Moreover, the Panel found that contracts made after November 18, 1999, had also not been modified to comply with the WTO ruling.¹²⁰ It dismissed Brazil's argument that the support was necessary because of high domestic interest rates and "Brazil Risk," finding that whether interest rates were at or above CIRR rates was highly relevant.¹²¹ However, the Panel found that CIRR was not an immutable test and that if the interest rate was below CIRR,¹²² it was still proper if it was not lower than the minimum commercial rate for that state.¹²³ Brazil had failed to produce any evidence of export credits being provided in the commercial markets at the levels of PROEX.¹²⁴

One hotly contested issue revisited by the Panel was the meaning of the Illustrative List of Export Subsidies contained in item (k) of Annex I to the SCM Agreement.¹²⁵ Brazil argued that since the PROEX measures were not used to secure a material advantage, PROEX did not fall within Annex I, item (k) and, therefore, should be permitted.¹²⁶ Brazil again argued that items not falling within paragraph one of item (k) should be interpreted *a contrario* as a list of permitted measures.¹²⁷ The Panel found that there were no such measures except those permitted under Footnote 5, which states, "Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement."¹²⁸ The Panel decided that this footnote merely means that any permitted subsidies by definition did not confer material advantage under item (k).¹²⁹ It found that the first paragraph of item (k) could not be used to establish an *a contrario* list of permitted

118. WTO Dispute Panel, *Brazil - Export Financing Programme for Aircraft*, WT/DS46/RW (May 9, 2000), reprinted in 4 INT'L TRADE REP. 8, paras. 6.17, 7.34-7.37 (2000), available at <http://www.wto.org> and 2000 WL 668957 [hereinafter WT/DS46/RW].

119. *Id.*

120. *Id.*

121. Robert Evans, *Ottawa Poised for Trade War with Brazil*, TORONTO STAR, May 23, 2000, at B1, available at 2000 WL 21247570.

122. WT/DS46/RW, *supra* note 118, para. 6.84.

123. *Id.* para. 6.86.

124. *Id.* para. 7.36.

125. *Id.* para. 6.66.

126. *Id.*

127. *Id.* paras. 4.53-4.71.

128. WT/DS46/RW, *supra* note 118, para. 6.46.

129. *Id.* paras. 6.46-6.67; see also Final Act, *supra* note 2.

subsidies and stated that if they had given a different interpretation, the *raison d'être* of Footnote 5 would be called into question.¹³⁰

The Panel also stated that Brazilian measures, which were designed to match Bombardier subsidies of a similar nature were still GATT-illegal.¹³¹ The Panel found that developing countries could not use the first paragraph of item (k) of the Illustrative List to meet developed country competition and stated that if a developing country encountered an export credit it could not meet, while still respecting its obligations in the SCM Agreement, the proper avenue of challenge was the DSB.¹³²

On the same date, May 9, 2000, the decision of the Panel on the challenged Canadian subsidies was released.¹³³ This decision ruled on the issue of whether the changes made by Canada to TPC and Canada Account had implemented the August 1999 Appellate Body decision complying with SCM Agreement obligations.¹³⁴ The Panel found that while Canada had complied with the ruling regarding Canada Technology Partnerships,¹³⁵ changes to the Canada Account program were insufficient.¹³⁶ Canada Account merely issued a policy guideline that insured that future Canada Account financing would be in accordance with the OECD Arrangement.¹³⁷ The Panel did not find this satisfactory, holding that Canada Account did not comply with the interest rate provisions of the OECD Arrangement and therefore did not qualify for the "safe haven" of the second paragraph of item (k) of Annex I to the SCM Agreement.¹³⁸ Interestingly, the Panel declined Canada's request to endorse compliance verification procedures for the Canada Account program.¹³⁹ It gave

130. WT/DS46/RW, *supra* note 118, para. 6.41.

131. *Id.* para. 6.98.

132. *Id.* para. 6.107.

133. WTO Dispute Panel, *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/RW (May 9, 2000), reprinted in 8 INT'L TRADE REP. 9 (2000), available at <http://www.wto.org> and 2000 WL 668958 [hereinafter WT/DS70/RW].

134. *Id.*

135. WT/DS70/AB/R, *supra* note 48, paras. 60-63. Canada significantly restructured the Canada Technology Partnership, including a modification of objectives, a new definition of eligible activities, a reorientation of assessment criteria, enhanced transparency, and a restructuring of risk and reward sharing. *Id.*

136. This involved issuance of a policy guideline that insured that future Canada Account financing transactions would be in accordance with *OECD Arrangement on Guidelines for Officially Supported Export Credits*. *Id.*

137. WT/DS70/RW, *supra* note 133.

138. *Id.* Both CIRR and the other rules in the OECD Arrangement were found to be relevant. *Id.*

139. *Id.*

Canada ninety days to bring the Canada Account program into compliance.¹⁴⁰

The government of Canada requested WTO authorization to take countermeasures against Brazil in the amount of \$700 million (Can.) per year for seven years under Article 22.6 of the DSU and initiated public consultations to hear public and industry concerns regarding retaliation.¹⁴¹ The Canadian proposals for countermeasures were extensive and not limited to the aircraft industry.¹⁴² They included a 100 percent surtax on selected imports from Brazil in addition to any existing rates of duty, suspension of Brazil from the list of countries eligible for the General Preferential Tariff¹⁴³ treatment, and suspension of injury inquiries under Canada's *Special Import Measures Act* in countervailing duty investigations with respect to goods from Brazil that benefit from PROEX subsidies.¹⁴⁴ Canada not only requested suspension of their obligations to Brazil under the WTO Agreement on Textiles and Clothing, but also suspension of Canada's obligations to Brazil under the WTO Agreement on Import Licensing.¹⁴⁵ Several WTO members, including the European Union, Malaysia, and Argentina, agreed publicly with the Brazilian position that Canada should have waited for the results of the pending Brazilian appeal before releasing its arbitration request for countermeasures.¹⁴⁶

Bombardier stated publicly that it had lost \$10 billion (U.S.) in sales and 25,000 person-years of work because of the Brazilian subsidies and claimed that if those subsidies were not removed soon, it would necessitate cutbacks at its Toronto plant.¹⁴⁷ Bombardier took the position that Canada should have asked

140. *Id.*

141. Communication from the Permanent Mission of Canada, *Brazil - Export Financing for Aircraft*, WT/DS46/16 (May 11, 2000), available at <http://www.wto.org> and 2000 WL 631038 [hereinafter WT/DS46/16].

142. *Id.*

143. The general preferential tariff is a unilateral tariff preference that Canada grants for most imports from developing countries. CANADA CUSTOMS AND REVENUE AGENCY, TARIFF TREATMENT - ORIGIN - IMPORTED GOODS, available at http://www.infoentrepreneurs.org/english/display.cfm?code=1560&coll=FE_FEDSBIS_E (last visited Nov. 1, 2002).

144. WT/DS46/16, *supra* note 141.

145. Agreement on Textiles and Clothing, Apr. 15, 1994, art. 15, WTO Agreement, Annex, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND, vol. 1, available at <http://www.wto.org> (last visited Oct. 9, 2002).

146. *Canada Pushes on Sanctions Against Brazil*, GLOBE AND MAIL (Toronto), May 23, 2000, at A6.

147. Heather Scofield, *Trade Attack Launched on Brazil*, GLOBE AND MAIL (Toronto), May 10, 2000, at B1.

for the \$10 billion (U.S.) in sanctions rather than the \$4.9 billion (U.S.) it actually asked for.¹⁴⁸

In May of 2000, there were ongoing negotiations between the two countries to try to avert a trade war, which some experts feared would damage trade with the whole region given Brazil's heavyweight status at regional trade discussions.¹⁴⁹ In June of 2000, it appeared they had reached an agreement in principle.¹⁵⁰ The negotiations collapsed, however, as Brazil was not ready to accede to the Canadian condition that new sales at Embraer halt during the negotiations.¹⁵¹

On July 21, 2000, the WTO Appellate Body ruled that Brazil had not brought the PROEX subsidy program into compliance and that those subsidies continued to be illegal.¹⁵² The Appellate Body looked at the issue of whether PROEX bonds,¹⁵³ granted by letter of commission before November 18, 1999, were illegal and found that they were indeed prohibited by the SCM Agreement, Section 3.1(a).¹⁵⁴ Brazil argued that because there were certain letters of commitment outstanding for PROEX, those subsidies had already been granted, but that argument was again rejected.¹⁵⁵ The Appellate Body commented that the lending institutions were often international institutions without the "special costs" cited by Brazil as justification for PROEX.¹⁵⁶ Again, one of the most contentious issues was whether the Illustrative List, item (k) paragraph 1 in Annex I of the SCM Agreement, was intended to establish that anything that did not fall within the scope of that section was a "permitted" subsidy.¹⁵⁷ The Appellate Body found that those subsidies

148. *Id.*

149. *Id.*

150. Joel Baglole & Christopher J. Chipello, *Canada, Brazil Set Frame For Trade Settlement*, WALL ST. J., June 26, 2000, at A4, available at 2000 WL-WSJ 3034258.

151. Scoffield, *supra* note 147, at B1.

152. WTO Appellate Body, *Brazil - Export Financing Programme for Aircraft*, WT/DS46/AB/RW (July 21, 2000), reprinted in 4 INT'L TRADE REP. 8, 26-29 (2000), available at <http://www.wto.org> and 2000 WL 1011031 [hereinafter WT/DS46/AB/RW]. Under the DSU, which refers in Article 26.5 to "these provisions," Article 21.5 panel disputes can be appealed to the Appellate Body. *Id.* The Appellate Body now had the dispute before it for the second time. *Id.*

153. The Appellate Body stated that these bonds were often granted over a fifteen year term (in this case, thirty payments over fifteen years). *Id.* They could be held over their term or sold on the market at a discount. *Id.*

154. WT/DS46/AB/RW, *supra* note 152.

155. *Id.*

156. *Id.*

157. *Id.*

were only justified under the first paragraph of (k) if the measure was not used to secure a material advantage in the field of export credit terms.¹⁵⁸ The market benchmark was whether the interest rate was at or above the CIRR rates or another appropriate benchmark.¹⁵⁹ The Appellate Body found that Brazil had the burden of proof and could not meet its burden.¹⁶⁰ The Appellate Body rejected the two examples of similar rates in other transactions cited by Brazil, stating that a single transaction could not be considered a market benchmark.¹⁶¹ Because Brazil failed to prove that PROEX was not used to secure a material advantage in the field of export credit terms, it was unnecessary to examine the second part of the test: whether the export subsidies were 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) of the Illustrative List.¹⁶² Therefore, it held that the Panel's findings on that point were moot.¹⁶³ Having avoided the "permitted subsidies" issue, the Appellate Body declined to comment on the meaning of Footnote 5 or the items in the Illustrative List.¹⁶⁴

At the same time, the Appellate Body confirmed that the Technology Partnerships program of Canada was now in full compliance with international trade obligations.¹⁶⁵ The Panel declined to examine the changes to the Canadian TPC program and whether the revised version was now in compliance with the SCM Agreement.¹⁶⁶ The Appellate Body said that under Article 21.5 of the DSU, the Appellate Body may examine not only whether the Panel decision had been implemented, but also whether the new program was SCM Agreement-compliant.¹⁶⁷ Therefore, the new facts were relevant. The Appellate Body found that the Panel had erred in declining to examine whether

158. *Id.* paras. 175-79.

159. WT/DS46/AB/RW, *supra* note 152.

160. *Id.*

161. *Id.* paras. 70-73. The transaction was also inapposite as it was guaranteed by the government. *Id.* The other transaction Brazil cited was one involving Canadian EDC export credits. *Id.*

162. *Id.*

163. *Id.* para. 177.

164. *Id.*

165. WTO Appellate Body, *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/RW (July 21, 2000) reprinted in 4 INT'L TRADE REP. 9, para. 1.3 (2000), available at <http://www.wto.org> and 2000 WL 1011030 [hereinafter WT/DS70/AB/RW].

166. *Id.* paras. 12, 39.

167. *Id.* paras. 40-43.

the revised Canadian TPC program was “specifically targeted” to export under 3.1(a) of the SCM Agreement.¹⁶⁸ However, the Appellate Body ruled that Brazil failed to demonstrate that Canada’s revised TPC program had not implemented the recommended changes or was inconsistent with the SCM Agreement.¹⁶⁹ Brazil argued that because TPC listed “Aerospace” and “Defense” as the only two sectors expressly identified, it was specifically targeted to areas that were export oriented.¹⁷⁰ Brazil relied on statements made by government officials, members of Parliament, government ministers and TPC itself as evidence of prohibited export contingency.¹⁷¹ Brazil also mentioned the high allocation of TPC funds, in practice, to export items as evidence of specific targeting.¹⁷² However, the Appellate Body rejected this argument and stated that because there had been no transactions under the “new” TPC, targeting could not be demonstrated. The Appellate Body stated:

According to Brazil, sixty-five percent of TPC funding has, in past, “gone to the [Canadian] aerospace industry.” Brazil maintains that the reason for these two types of targeting is the high export orientation of the industry. In this, Brazil relies upon a series of statements made by Canadian Government Ministers, Members of Parliament, other government officials, and by TPC itself. . . . In these proceedings, we do not see the two “targeting factors”, by themselves, as adequate proof of prohibited export contingency. . . the evidence that Brazil relies upon in seeking to demonstrate that the Canadian regional aircraft industry is “specifically targeted” because of its high export-orientation relates to the TPC as previously constituted, not to the revised TPC programme. . . . Brazil has not offered any convincing evidence as to why the evidence relating to the old TPC programme continues to be relevant to the revised TPC programme. We do not believe we should simply assume that this particular piece of evidence is relevant with respect to the revised TPC programme.¹⁷³

The Appellate Body said that export orientation was not enough to demonstrate a relationship of conditionality or dependence of the subsidy to export performance. Export orientation can be a relevant fact, but not the only fact supporting a finding of prohibited export contingency.¹⁷⁴

168. *Id.*

169. *Id.* paras. 47-55.

170. *Id.* para. 44.

171. WT/DS70/AB/RW, *supra* note 165, para. 45.

172. *Id.* para. 44.

173. *Id.* paras. 44-51.

174. *Id.* paras. 48-49.

III. COUNTERMEASURES AND TRADE WARS

A. THE COUNTERMEASURE BATTLE

On August 28, 2000, the Arbitration Report was released pursuant to DSU Article 22.6 regarding the quantum of retaliation allowable.¹⁷⁵ Under Article 22.7, the arbitrators were not to examine the nature of the concessions or other obligations to be suspended, but were to determine whether the level of such suspension was equivalent to the level of nullification or impairment of benefits.¹⁷⁶ The arbitrators held that \$344.2 million (Can.) per year for six years in countermeasures could be taken by Canada against Brazil.¹⁷⁷ While this was only a portion of what Canada had requested, it still was one of the highest amounts ever authorized by the WTO for retaliation.¹⁷⁸ The Arbitrators found that Brazil, as the challenger of the countermeasures, had the burden of proof.¹⁷⁹ Brazil, stating it was not in a position to provide information on the issue, accepted the "unit price" of each model of Embraer's regional jets proposed by Canada.¹⁸⁰ The Arbitrators made a point of stating that protection of confidential information was crucial to the co-operation of members and private parties and provided two versions of the reports, one for all member states of the WTO and a version with more sensitive information for the parties' eyes alone.¹⁸¹

Brazil also tried to argue that because there had been an agreement between the parties earlier and the time to propose countermeasures under the agreement had expired, Canada had no authority to propose countermeasures.¹⁸² The Arbitrators, however, referred to the fact that no time limit was specified in Article 22.6 of the DSU.¹⁸³

One of the most interesting portions of the Arbitration Re-

175. Decision by the Arbitrators, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/ARB (Aug. 28, 2000), available at <http://www.wto.org> and 2000 WL 1251329 [hereinafter WT/DS46/ARB].

176. Final Act, *supra* note 2, at art. 22.7.

177. WT/DS46/ARB, *supra* note 175. This is the equivalent of \$233.5 million (U.S.).

178. Heather Scoffield, *Canada's Brazil Sanction Level Slashed*, GLOBE AND MAIL (Toronto), Aug. 23, 2000, at B1.

179. WT/DS46/ARB, *supra* note 175, para. 2.8.

180. *Id.*

181. *Id.* para. 2.14.

182. WTO Bilateral Agreement, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/13 (Nov. 23, 1999), available at <http://www.wto.org>.

183. WT/DS46/ARB, *supra* note 175, para. 3.6.

port concerned the method of calculation of the subsidy. Brazil argued that the calculation of countermeasures must include a direct comparison of the types of aircraft involved. It specifically argued that because there were no thirty-seven seat jets built in Canada, subsidies for those transactions should not be included in the calculation.¹⁸⁴ Brazil said that, therefore, the calculation should not include the full amounts of payments under PROEX, but only those which secure a material advantage and produce verifiable nullification or impairment.¹⁸⁵ The question of nullification or impairment was examined by the Arbitrators when deciding the amount of countermeasures in a different context when deciding whether there has been breach of a covered agreement.¹⁸⁶

The question the Arbitrators had to decide was, when calculating countermeasures under Article 4 of the SCM Agreement and the DSU, whether the calculation should ensure that the amount is equivalent to the level of nullification or impairment.¹⁸⁷ The Arbitrators examined this issue carefully but rejected the Brazilian argument, finding that "appropriate" countermeasures under Section 4 of the SCM Agreement meant measures that *effectively induce compliance*.¹⁸⁸ The Arbitrators stated that a violation of Section 3 of the SCM Agreement created an irrefutable presumption of nullification or impairment.¹⁸⁹ They rejected an argument based upon footnotes 9 and 10 of the SCM Agreement, which identically state, "This expression is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited."¹⁹⁰ Brazil argued that countermeasures based upon the full amount of the subsidy, which do not take into account the number of sales of aircraft with respect to which Canada suffers nullification or impairment, would be disproportionate.¹⁹¹ The Arbitrators specified that they did not draw any firm conclusion as to the meaning of footnotes 9 and 10 of the SCM Agreement.¹⁹² The Arbitrators stated that

184. *Id.* para. 3.61.

185. *Id.*

186. *Id.* paras. 3.54-3.60.

187. *Id.* para. 3.44.

188. Referring to an identical definition of that term by the *Bananas* panel. *Id.* paras. 3.44-3.49.

189. WT/DS46/ARB, *supra* note 175, para. 3.48.

190. *Id.* paras. 3.50-3.54.

191. *Id.* para. 3.59.

192. *Id.* para. 3.51.

in the context of the obligation to withdraw a measure that violated a covered agreement, *countermeasures need not be based only on the level of nullification or impairment*.¹⁹³ Rather, inducing compliance with WTO obligations is the paramount concern.¹⁹⁴ The problem with the Arbitrators' holding is that if such an irrefutable presumption of nullification or impairment exists under Section 3, then it is unclear what the reference to "disproportionate" could mean and if or how any a party must demonstrate that a proposed countermeasure would be disproportionate.¹⁹⁵

Brazil also argued that since Canada chose to apply countermeasures, it could not ask for those countermeasures in the amount of the subsidy, since Article 22.4 of the DSU limits countermeasures to the amount of the nullification or impairment.¹⁹⁶ Rejecting that argument, the Arbitrators ruled that the total amount of the PROEX payments should be used to determine the countermeasures.¹⁹⁷ Issues such as which types of aircraft were in competition were held to be irrelevant to the countermeasures taken in response to the original trade-distorting measure.¹⁹⁸ They stated,

Actually, given that export subsidies usually operate with a multiplying effect (a given amount allows a company to make a number of sales, thus gaining a foothold in a given market with the possibility to expand and gain market shares), we are of the view that a calculation based upon the level of nullification or impairment would, as suggested by the calculations of Canada based upon the harm caused to its industry, produce higher figures than one based exclusively on the amount of the subsidy. On the other hand, if the actual level of nullification or impairment is substantially lower than the subsidy, a countermeasure based on the actual level of nullification or impairment will have less or no inducement effect¹⁹⁹ and the subsidizing country may not withdraw the measure at issue.

Countermeasures need to be tied to the amount of nullification and impairment and to be specifically tied to the industry at issue if the SCM Agreement are to be effective.²⁰⁰ Although Article 22.3(a) directs a party seeking to impose countermeasures to consider the general principle that if possible they

193. *Id.* para. 3.58.

194. *Id.* para. 3.54

195. WT/DS46/ARB, *supra* note 175 (regarding arbitrators' discussion).

196. *Id.* para. 3.53.

197. *Id.*

198. *Id.* paras. 3.54, 3.62.

199. *Id.*

200. Final Act, *supra* note 2, at art. 22, at Annex 2.

should be directed to the same sector as that against which a violation has been found, subsection (b) allows that party to direct it towards other sectors and in subsection (c) towards other covered agreements if the party considers the other options not practical or effective.²⁰¹ Under Article 22.3(e), the parties need merely state the reasons therefore.²⁰² The Arbitrators stated that Brazil had the burden of proof to make a prima facie case “presumption” why the proposed countermeasures were inappropriate and then Canada had the burden to rebut that “presumption.”²⁰³

Canada continued to take the position that Brazil’s claims that Brazil was in compliance were no more than “a unilateral assertion” and awaited clearance from the DSB to move forward with sanctions. It received this clearance on December 12, 2000.²⁰⁴ Despite receiving formal permission to retaliate for the continued use of PROEX, Canada had yet to decide on specific retaliatory measures to be imposed, only citing the \$344.2 million (Can.) per year they were allowed to impose by the Panel.²⁰⁵ In December 2000, Brazil announced that the country would start using the CIRR issued monthly by the Paris-based Organization for Economic Co-operation and Development to set its level of support for Embraer.²⁰⁶ Numerous meetings took place between Canada and Brazil to discuss Brazil’s implementation of the WTO ruling in order to avoid retaliation.²⁰⁷ None were successful and Canada’s image in Brazil became that of a First World country trying to keep Brazil from exporting hi-tech products, forcing it to export only low-technology items such as coffee beans.²⁰⁸

201. *Id.* at art. 22.3.

202. *Id.* at art. 22.3(e).

203. WT/DS46/ARB, *supra* note 175, para. 2.8.

204. Annette Hester, *There’s a Reason to Beef about Ottawa’s Brazil Policy*, GLOBE AND MAIL (Toronto), Feb. 19, 2001, at A13. The request by Canada can be found at Communication from the Permanent Mission of Canada, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/25 (Dec. 1, 2000), available at <http://www.wto.org> and 2000 WL 1772298 [hereinafter WT/DS46/25]. The minutes of the meeting are available at Minutes of Meeting, WT/DSB/M/94 (Feb. 15, 2001), available at <http://www.wto.org> (last visited Oct. 10, 2002).

205. WT/DS46/25, *supra* note 204.

206. Michael Marray, *Locked Horns*, AIRFIN. J. (May 2001), available at www.airfinancejournal.com.

207. *Id.*

208. MacKinnon, *supra* note 9.

B. TOWARD A TRADE WAR

In January of 2001, Brazil's Agriculture Minister Marcus de Pratini Morales said that his country might boycott Canadian potassium chloride, a chemical fertilizer, and possibly other agricultural products if Canada pressed ahead with sanctions. He stated, "A retaliation will be worse for Canada than for us. The farming sector will be the first to respond, as everything Brazil imports from Canada in this sector can be substituted."²⁰⁹ Agricultural exports to Brazil, including potassium chloride, are worth over \$400 million (U.S.) annually.²¹⁰ Predictably, Canada's importers of Brazilian footwear, steel, and coffee claimed that consumer prices would increase, that some products would disappear from the market, and that they were being held hostage when they had nothing to do with aircraft.²¹¹

In February 2001, Canada announced that it was returning to the WTO for another ruling on Brazil's non-compliance,²¹² which Brazil used procedural objections to temporarily block.²¹³ Brazil also announced it would challenge the Canadian move to provide \$2 billion (U.S.) in cut-rate loan guarantees to Bombardier through the Canada Account to help it secure a 150-jet contract with Air Wisconsin, an affiliate of United Airlines.²¹⁴ The Canadian Industry Minister, Brian Tobin, declared that such assistance was a necessary response to continued Brazilian subsidies.²¹⁵ Brazil also announced that it was preparing a number of legal arguments to prevent the same panel that issued a deci-

209. Mark MacKinnon, *Brazil, Canada Edge Closer to Trade War*, GLOBE AND MAIL (Toronto), Jan. 24, 2001, at B5.

210. *Id.*

211. Mark MacKinnon & Shawn McCarthy, *Diplomats Talk Tough on Trade with Brazil*, GLOBE AND MAIL (Toronto), Feb. 1, 2001, at B3 (repeating remarks by Bob Armstrong, President of the Canadian Association of Importers and Exporters).

212. Mark MacKinnon & Shawn McCarthy, *Canada Returns to WTO for Brazil Subsidy Ruling*, GLOBE AND MAIL (Toronto), Feb. 1, 2001, at B3. Canada sought the ruling at Communication from the Permanent Mission of Canada to Article 21.5 of the DSU, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/26 (Jan. 22, 2001), available at <http://www.wto.org> and 2001 WL 63037. The matter was also referred to the original panel by the DSB, Communication by the Secretariat, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/27 (Feb. 22, 2002), available at <http://www.wto.org> and 2001 WL 175277 [hereinafter WT/DS46/27].

213. Press Release, *Brazil Blocks Canada's Request for a WTO Ruling on Brazilian Aircraft Subsidy*, Feb. 1, 2001, at <http://www.dfait-maeci.gc.ca/tna-nac/aircraft-e.asp> (last visited Oct. 8, 2002).

214. Bombardier, *Brasil pedira panel na OMC*, Feb. 21, 2001, at <http://www.estadao.com.br/agestado/>.

215. MacKinnon, *supra* note 9.

sion on the previous cases from hearing the new case.²¹⁶ The top Brazilian trade negotiator, Jose Alfredo Graca Lima, told the press in February 2001 that Canada's sole goal was the elimination of PROEX, but that Brazil sees the program as necessary to level the playing field between developing and developed countries.²¹⁷

Embraer's vice-president of external relations, Henrique Rzezinski, told the press that Canada was into the subsidy game as much as Brazil, but doing it much more quietly. He alleged Canada subsidized through the Economic Development Corporation (EDC), which does not have to report to whom it loans money and what conditions are imposed.²¹⁸ He also charged Canada with hypocritical "imperialism," in that a developed country trying to deny a developing country the tools it once used itself to achieve success.²¹⁹ Rzezinski pointed to the fact that Canada had not taken the European Union or the United States to the WTO over agricultural subsidies, stating that the message being sent was that Brazil exports coffee beans and Canada exports airplanes, and that is the way it should stay.²²⁰

Embraer's president, Mauricio Botelho, described the WTO ruling as an "absolutely unjust" application of a double standard, "one for developing countries and another for advanced countries," and accused Bombardier of attempting to crush competition.²²¹ Botelho also pointed out that "we continue to rack up sales at a record rate," and indeed, Canada intends for Embraer to move into the bottom end of the full-size jet market, with plans for ninety-eight and one-hundred eight seat versions of its regional jets.²²² Embraer urged some of its U.S., Japanese, and European suppliers to open up factories in Brazil and several have committed to do so.²²³ Mr. Botelho was confident of Embraer's future, stating, "we're not going to deviate from the vision that brought us this far."²²⁴ However, there are those that doubt that privatization under Mr. Botelho's leadership was the key to Embraer's success, including the first president of Em-

216. *Brazil Thwarts Canada's WTO Move*, GLOBE AND MAIL (Toronto), Feb. 2, 2001, at B5.

217. McKinnon & McCarthy, *supra* note 212.

218. *Id.*

219. *Id.*

220. *Id.*

221. Rohter, *supra* note 34.

222. *Id.*

223. *Id.*

224. *Id.*

braer, Ozires Silva, now head of Varig Airlines. Silva stated that,

Nowhere in the world can enterprise of this sort be built or meet with success without orders from the government or the military. The military always wants to be in the lead in technology, so it covers the costs, and the civilian sector is in the end the big beneficiary. The development of the Internet was like that, and our situation is no different.²²⁵

Because Embraer was such a symbol of Brazilian hopes, public anger in Brazil went far beyond politicians, to ranchers and restaurateurs for whom Canada was now an enemy. Brazilian dock workers threatened to refuse Canadian cargoes and radio show hosts barred Canadian music.²²⁶ The anger in Brazil was further fueled by the 2001 Canadian ban on Brazilian beef on "mad cow disease" grounds, which was seen merely as a pretext to harm Brazil over the jet subsidy issue.²²⁷ It appears that the Brazilians were correct, for there was little scientific data that Canada could produce to justify its actions.²²⁸

The beef ban created a furor in Brazil. There were allegations by Canadian scientists to the press that they, themselves, had not even been consulted on the beef ban and a Health Canada scientist was suspended for speaking out publicly.²²⁹ Free trade partners, the United States and Mexico, were obligated to follow the ban, which was imposed upon the grounds of "theoretical risk" of mad cow disease.²³⁰ Both the United States and Mexico decided to reconsider the ban given the lack of a single case of mad cow disease in Brazil.²³¹ Angry Brazilian officials, stating that there had never been a case of mad cow disease documented in Brazil, vowed that if Canada did not cease the measures immediately, it would start a large trade war.²³²

Products said to be on Brazil's list for retaliatory suspension

225. *Id.*

226. Reese Ewing, *Canada-Brazil Firms Demand Immediate End to Beef Ban*, GLOBE AND MAIL (Toronto), Feb. 16, 2001, at B1; see also Mark MacKinnon, *Scientists Rip Mad-Cow 'Ruse'*, GLOBE AND MAIL (Toronto), Feb. 9, 2001, at A1.

227. Mark MacKinnon, *Mad-Cow Ban on Brazil a 'Ruse,' Scientists Say*, GLOBE AND MAIL (Toronto), Feb. 9, 2001, at A1.

228. *Id.*

229. Keith McArthur, *Ottawa Scientist Suspended*, GLOBE AND MAIL (Toronto), Feb. 21, 2001, at A6.

230. North American Free Trade Agreement, Dec. 17, 1992, art. 756, 32 I.L.M. 605.

231. Mark MacKinnon, *Brazil Turns Up the Heat over Canada's Beef Ban on Monday*, GLOBE AND MAIL (Toronto), Feb. 8, 2001, at B1.

232. *Id.*

were worth about \$300 million (U.S.) a year.²³³ Brazil also moved toward suspending all trade agreements with Canada until the beef ban was lifted.²³⁴ A resolution to that effect was unanimously approved by the Brazilian Congress and went to the executive branch for approval.²³⁵ There was concern that Canada's trade and investment cooperation agreement with Brazil and other South American countries, a precursor to a free trade deal, might be affected.²³⁶ However, Canada refused to lift the ban and said that it would wait for the findings of food inspectors, despite a threat by President Cardoso on February 9, 2001, stating that if Canada did not lift the ban in three weeks, Brazil would retaliate, complain to the WTO, and abandon talks on free trade scheduled for the Summit of the Americas in spring of 2001.²³⁷ Brazil was also vocal about its view that the existing trade pacts did not adequately address the needs of the developing world.²³⁸

During this period of escalating hostility over regional jets, Canada requested yet another panel review of the revised PROEX.²³⁹ At the Summit of the Americas in Quebec City in April 2001, Brazil and several smaller nations blocked proposals for moving the completion of the FTAA negotiations up to 2003.²⁴⁰ The ministers settled instead on reducing the schedule for talks by one year.²⁴¹

The hostile Brazilian reaction to this perceived threat to national sovereignty was not without some irony, given the enormous level of financial support, over \$40 billion (U.S.), that Brazil has received through the International Monetary Fund and other sources over the last few years.²⁴² Clearly, Brazil wishes this economic support to continue, but views attempts to regulate trade practices through international organizations such as the WTO as an intrusion on Brazilian sovereignty and arouse

233. Mark MacKinnon, *Brazil May Retaliate for Canadian Beef Ban*, GLOBE AND MAIL (Toronto), Feb. 7, 2001, at A7.

234. MacKinnon, *supra* note 231.

235. *Id.*

236. *Id.*; Mark MacKinnon, *Beef Ban Could End as Brazil Talks Tough*, GLOBE AND MAIL (Toronto), Feb. 10, 2001, at A1.

237. MacKinnon, *supra* note 231.

238. *Id.*

239. WT/DS46/27, *supra* note 212.

240. *FTAA Talks Show Impact of Anti-Trade Demonstrations*, WASH. TARIFF & TRADE, Apr. 16, 2001, at 1, available at <http://wttlonline.com>.

241. *Id.*

242. INTERNATIONAL MONETARY FUND, BRAZIL: COMPOSITION OF THE SUPPORT PACKAGE, at <http://www.imf.org/external/exr/facts/brazil/htm> (Nov. 17, 1998).

much passionate anger in Brazil.²⁴³

As for Bombardier, its problems with Embraer did not prevent it from recently winning a contract with Mesa Air Group of Phoenix worth \$1.2 billion (U.S.) with options for another forty aircraft worth more than \$1 billion (U.S.).²⁴⁴ Subsequently, on April 16, 2001, Bombardier announced that it had closed a deal to sell up to seventy-five jets to Air Wisconsin, carrying a \$2.35 billion (U.S.) price tag.²⁴⁵ The deal was supported by loan guarantees from the Canadian federal government.²⁴⁶ Bombardier asked Canada for federal funding enabling it to land a \$1.5 billion (U.S.) order for sixty to seventy-five jets with Northwest Airlines.²⁴⁷ Correspondingly, Prime Minister Chretien said publicly that Canada would "fight fire with fire" in the battle with Brazil for regional aircraft market share.²⁴⁸

Brazil responded to this by requesting the establishment of a DSU panel on the issue of the Bombardier subsidies.²⁴⁹ In July 2001, a panel ruling in Canada's case against Brazil found that PROEX was not per se illegal as long as financing was at market rates plus a premium for risk, loans were for no longer than ten years, and the loans did not cover more than eighty-five percent of the purchase price.²⁵⁰ The Article 21.5 Panel found that since Brazil claimed that PROEX III payments would conform in practice to the OECD Arrangement and use CIRR as a minimum, it was not used to confer a material advantage in the field of export terms. The panel held that in any event the program was justified under paragraph 2 of item (k) of the Illustrative List but not under paragraph 1 as an affirmative defense.²⁵¹ With this determination, both Brazil and Canada

243. Ewing, *supra* note 226.

244. Keith McArthur, *Bombardier Wins Jet Contract*, GLOBE AND MAIL (Toronto), Mar. 22, 2001, at B8.

245. Keith McArthur, *Bombardier Deal Will Add 10,00 Jobs*, GLOBE AND MAIL (Toronto), Apr. 17, 2001, at A1.

246. *Id.*

247. Keith McArthur, *Bombardier Asks Ottawa for Help in Landing Jet Deal*, GLOBE AND MAIL (Toronto), May 23, 2001, at B3.

248. Mark MacKinnon, *PM Vows to 'Fight Fire with Fire' in Trade Disputes*, GLOBE AND MAIL (Toronto), May 30, 2001, at B3.

249. WTO Panel Report, *Canada - Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/2 (Mar. 1, 2001), available at <http://www.wto.org> [hereinafter WT/DS222/2].

250. WT/DS46/R, *supra* note 42.

251. *Id.* Even though there was flexibility on the part of the Brazilian government regarding the rate, the panel found that there was no breach since the program did not require Brazil to act inconsistently with its obligations under the SCM Agreement. *Id.* The panel decision was adopted by the DSB. WTO Dispute Panel

claimed victory in the panel ruling.²⁵²

Afterward, the dispute between Brazil and Canada continued to move in a bizarre direction.²⁵³ In July of 2001, Brazil moved to ban Canadian beef on mad cow disease grounds.²⁵⁴ This was widely seen as mere retaliation over the jet controversy and Canada's ban of Brazilian beef.²⁵⁵ Days later, Bombardier announced that it had won a \$1.68 billion (U.S.) contract with Northwest Airlines, with a government loan package of up to \$1.2 billion (U.S.), eighty percent of the purchase price, with a fifteen year loan period.²⁵⁶ Canada said it was merely matching illegal subsidies by Brazil and that Brazil would therefore have no grounds to retaliate, although some government officials asking not to be named, confided their doubts to the press.²⁵⁷ With this action, Canada was clearly ignoring the comments of the Appellate Body in 1999 and the May 2000 Panel, which made it plain that there could be no "matching" of GATT-illegal subsidies with other GATT-illegal subsidies.²⁵⁸

Meanwhile, Brazil proceeded with the case it filed in March 2001, alleging subsidies through the Canada Account, TPC and the Province of Quebec.²⁵⁹ On October 25, 2001, an interim report found that the \$1.1 billion (U.S.) in financing provided by Canada was an illegal subsidy.²⁶⁰ Despite the ruling, Canada said it would go ahead with the assistance on the Air Wisconsin sale.²⁶¹ In the wake of the September 11, 2001 terrorist attacks, Bombardier intensified its efforts to seek financing, meeting

Settlement Body, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/29 (Aug. 28, 2001), available at <http://www.wto.org> (last visited Oct. 8, 2002).

252. Heather Scoffield, *Canada Won't Appeal Brazil Subsidies*, GLOBE AND MAIL (Toronto), Aug. 24, 2001, at B3.

253. Colin Freeze, *Brazil Slaps Import Ban on Canadian, U.S. Cattle*, GLOBE AND MAIL (Toronto), July 3, 2001, at A4.

254. *Id.*

255. *Id.*

256. Keith MacArthur, *Ottawa Saves Millions for Northwest*, GLOBE AND MAIL (Toronto), July 11, 2001, at B3.

257. Mark MacKinnon, *Ottawa Admits Subsidies in Grey Area*, GLOBE AND MAIL (Toronto), July 27, 2001, at B5.

258. WS/DS46/13, *supra* note 115, para. 6.107.

259. WTO Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/2 (Mar. 1, 2001), available at <http://www.wto.org>.

260. Daniel Pruzin & Peter Meyasz, *WTO Decision Puts Pressure on Brazil, Canada to Resolve Aircraft Subsidy Dispute*, 18 INT'L TRADE REP. 1706, 1706 (2001).

261. Heather Scoffield & Steven Chase, *Ottawa Braces for WTO Defeat Trade Body to Issue Ruling on Whether Loans Supporting Bombardier Are Wrong*, GLOBE AND MAIL (Toronto), Oct. 18, 2001, at B1.

with both the Canadian and British governments.²⁶² At the November 2001 WTO meeting in Doha, the governments of Canada and Brazil agreed to meet to attempt to resolve the subsidy dispute.²⁶³ After a meeting on November 22, 2001, which did not provide a breakthrough, Brazil's chief negotiator told the press that he expected the October WTO final Panel Report to be the "trump card" in the hands of Brazil's team when negotiations resumed in January 2002.²⁶⁴ However, the final Panel Report was not released to the parties until January 28, 2002.²⁶⁵ While Brazil failed to prove prohibited export subsidies had been given in several cases or that the programs were illegal per se or "as applied," the Panel did find that the \$1.7 billion (Can.) EDC Canada Account financing for Air Wisconsin, as well as EDC financing for Air Nostrum and Comair, were illegal.²⁶⁶

The Panel rejected Canada's contention that the OECD Arrangement permitted matching under Article 29 and Articles 25 and 31 of Annex III.²⁶⁷ Some of the Panel's reasoning was based upon the difficulties of allowing unsupervised subsidy matching, noting that the parties would have often not known the terms and conditions they were entitled to match.²⁶⁸ However, the Panel did respond to Canada's argument that the WTO system was set up only for prospective remedies and stated that the *Australia-Leather-Article 21.5 Panel* suggested that there is room in the DSU to allow for retrospective remedies in the form of repayment in certain instances.²⁶⁹ The Panel noted that Article 23.1 of the DSU provides for dispute settlement through the DSU and thus prohibits unilateral self-help.²⁷⁰ The Panel also

262. Bertrand Marotte, *Bombardier Seeks Aid to Sell Jets to Airlines*, GLOBE AND MAIL (Toronto), Oct. 26, 2001, at B1.

263. *Aircraft Subsidy Talks on November 22, Pettigrew Says*, GLOBE AND MAIL (Toronto), Nov. 14, 2001, at B7.

264. *Id.*

265. Ed Taylor, *Brazil, Canada Continue WTO Discussions on Dispute over Regional Plane Subsidies*, 18 INT'L TRADE REP. 1914, 1915 (2001). The report was due to be circulated to the parties in late January 2001. See also WTO Dispute Panel Report, *Canada - Export Credits and Loan Guarantees for Regional Aircraft Communication from the Chairman of the Panel*, WT/DS222/5 (Dec. 18, 2002), available at <http://www.wto.org> [hereinafter WT/DS222/5].

266. Taylor, *supra* note 265.

267. WT/DS222/5, *supra* note 265, para. 7.174.

268. *Id.*

269. *Id.* para. 7.170. See also WTO Dispute Panel, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/RW, reprinted in 4 INT'L TRADE LAW REP. 1382 (2000) (Jan. 21, 2000), available at <http://www.wto.org> (last visited Oct. 8, 2002) [hereinafter WT/DS126/RW].

270. WT/DS222/5, *supra* note 265.

said that the OECD Arrangement was a “gentleman’s agreement,” whereas the SCM Agreement, being a binding obligation, did not need matching provisions to instill discipline.²⁷¹

Given the history of this particular case, this statement by the Panel is somewhat ironic. Canada perhaps did not improve matters when on the same day the Panel Ruling was released, Canadian Trade Minister Pierre Pettigrew told the press that the decision’s silver lining was that it gave Brazil a partial win and that a proud people like the Brazilians needed a WTO win before they could sit down and negotiate a settlement.²⁷² Pettigrew told the press that although he was going to make attempts to settle, Canada had not decided whether to appeal.²⁷³ Talks were set to resume February 8, 2002, in New York. Though the matter has not yet been resolved, Canada announced in February 2002, that it would not appeal the WTO ruling on the Bombardier subsidies.²⁷⁴ Furthermore, Canada and Brazil continued to negotiate throughout the summer and autumn of 2002, while awaiting a ruling on Brazilian retaliation, but have been unable to reach a settlement.²⁷⁵

IV. POTENTIAL IMPROVEMENTS FOR THE PROBLEMS ILLUMINATED BY THE JET DISPUTE

The trade war over regional jets between Canada and Brazil has required the DSB to attempt to clarify many provisions of the SCM Agreement and the DSU, but it has also served to highlight many of the dramatic difficulties in WTO dispute resolution. Fortunately, the regional jet example also suggests ways that the WTO can improve the process and in so doing, preserve its authority and progress toward an effective adjudicatory model. The importance of doing so should be self-evident as many world economies struggle in recession and higher-profile trade disputes over such items as steel tariffs dominate headlines.²⁷⁶

The first issue illuminated by this dispute is the issue of

271. *Id.* para. 7.176.

272. Steven Chase, *Pettigrew Sees Silver Lining in WTO Loss*, GLOBE AND MAIL (Toronto), Jan. 28, 2002, at B1.

273. *Id.*

274. *Ottawa Won't Appeal WTO Ruling on Jet Sales*, GLOBE AND MAIL (Toronto), Feb. 19, 2002, at B5.

275. Sandra Cordon, *Brazil, Canada Continue Talks to Resolve Dispute over Aircraft Sales*, CAN. PRESS, July 11, 2002, available at 2002 WL 23890893.

276. See generally *supra* notes 3-5 and accompanying text.

what is an appropriate benchmark to determine whether material advantage has been conferred.²⁷⁷ Brazil argued, unsuccessfully, that “Brazil Risk” increased the cost of financing and necessitated unusually complex financing structures for aircraft transactions.²⁷⁸ Therefore, a determination of what is appropriate under item (k) of the Illustrative List must account for such added cost.²⁷⁹ Canada has thus far prevailed in its position that only the CIRR of the OECD Arrangement is an appropriate benchmark, although the Panel and Appellate Bodies stopped short of finding that it was an immutable test.²⁸⁰

The logical conclusion is that the CIRR of the OECD Arrangement is, in reality, usually the determinative test to decide whether a GATT – illegal subsidy has been given.²⁸¹ Such a benchmark, set monthly, is the most realistic option for these types of loans, which often have ten-year terms.²⁸² Member states may attempt to offer evidence of other transactions made at lower than CIRR rates, however, one or two transactions will not suffice to establish a market benchmark.²⁸³ More problematic from the point of view of developing countries like Brazil is that they are not OECD members and did not participate in the *OECD Arrangement*, which is not a formal Act, but is referred to by the OECD itself as a “gentlemen’s agreement.”²⁸⁴ The lack of transparency of the OECD was a sore point with Brazil.²⁸⁵ If such member states do not wish to follow the CIRR benchmark and other relevant provisions of the Arrangement, they must initiate discussion about changing the SCM Agreement to incorporate an alternative benchmark that has the flexibility of the CIRR.²⁸⁶

Many export credit agencies in developing countries have

277. WT/DS46/AB/R, *supra* note 89; *see also supra* note 98 and accompanying text.

278. MacKinnon, *supra* note 9 and accompanying text.

279. *See supra* note 121 and accompanying text.

280. *See supra* note 89 and accompanying text.

281. WT/DS46/AB/R, *supra* note 89, para. 181; *see also supra* note 98 and accompanying text.

282. WT/DS46/R, *supra* note 42, para. 4.115.

283. WT/DS46/AB/RW, *supra* note 152, paras. 70-73; *see also supra* note 161 and accompanying text.

284. WT/DS222/5, *supra* note 265, para. 7.176; *see also Overview of the OECD: What is it? History? Structure of the Organization?*, at <http://www.oecd.org> (last visited Oct 9, 2002).

285. WT/DS70/AB/R, *supra* note 48, para. 214-16; *see also supra* note 112 and accompanying text.

286. WT/DS46/AB/RW, *supra* note 152, para. 80.

used the London Interbank Overnight Rate (LIBOR) as a reference.²⁸⁷ Alternatively, they could negotiate with OECD member nations to obtain some input into, and transparency of, the decision-making process of the Arrangement, possibly even incorporating some provision to deal with the problem that, in the jets dispute, was termed “Brazil risk” premium.²⁸⁸ If the WTO avoids dealing with this issue, it would only widen the gulf between developing and developed member states, giving developing member states the perception that they are “second-class” members of the WTO.²⁸⁹

A second area with serious flaws is the calculation and application of countermeasures.²⁹⁰ The decision on retaliatory measures to be taken by Canada demonstrated that in the calculation of countermeasures, the level of nullification or impairment to the complaining party will not necessarily determine the level of the countermeasures.²⁹¹ Instead, the benchmark is what will have an “inducing effect” and this, being somewhat vague and rarely effective, requires some clarification.²⁹² In this dispute, even though the amount of the countermeasures was very large and were to be spread across many industries, it has not had such an “inducing effect.”²⁹³ The only effect that has been produced is further political tension between Canada and Brazil and between developed nations and developing member states.²⁹⁴ A more pragmatic solution to this problem needs to be proposed.

One possible solution is that such countermeasures be tied to the level of nullification or impairment and should be directed toward the industry involved in the dispute.²⁹⁵ Therefore, Article 22.3(a) of the DSU either needs a stricter interpretation of its “general principle” of directing countermeasures toward the same industry, or Article 22 needs to be reformed so that the burden is placed on the party seeking countermeasures to show

287. Chakravarthi Raghaven, *DSB Adopts Brazil – Canada Compliance Panel Reports* (Aug. 4, 2000), at <http://www.twinside.org.sg/title/canada.htm> (last visited Oct. 8, 2002).

288. WT/DS222/5, *supra* note 265, para. 7.176

289. MacKinnon, *supra* note 9.

290. See WT/DS46/16, *supra* note 141 and accompanying text.

291. See WT/DS46/ARB, *supra* note 175, paras. 3.54-3.60.

292. *Id.*

293. WT/DS70/2, *supra* note 53.

294. See *supra* note 253, 272 and accompanying text.

295. Final Act, *supra* note 2, at art. 22, at Annex 2; *but see* WT/DS46/ARB, *supra* note 175, para. 20 (claiming that a countermeasure based on the actual level of nullification or impairment will have less or no inducement effect).

that it is impracticable to direct countermeasures toward that industry.²⁹⁶ Additionally, a mechanism is needed whereby, if as here a member cannot place tariffs on products in the same industry because the injured member does not import those products, it can direct an amount of subsidy, which matches the illegal subsidy to the injured member's main industry with DSB supervision.²⁹⁷ Article 4.10 of the SCM Agreement would need to be amended to outline such a mechanism.²⁹⁸ The intended effect would be to neutralize the original subsidy and thus encourage the complete removal of such subsidy programs.

If such supervised subsidy matching had been part of the process, it might have ended the dispute between Canada and Brazil at an early stage.²⁹⁹ When analyzing the viability of such a program, it is important to consider that a member with an important, heavily subsidized industry may choose, when faced with countermeasures, to absorb the blow rather than complying with a ruling.³⁰⁰ A member state is likely to continue to subsidize the industry when the state perceives the industry as significant to its national interests.³⁰¹ This may be true even when the amount of the countermeasures is very large.³⁰² Industries unrelated to the exports that are the subject matter of the dispute will then suffer the ultimate consequences.³⁰³ A Brazilian manufacturer of footwear may suffer the consequences of retaliatory measures, rather than Embraer.³⁰⁴ A DSB supervised, subsidy-matching program would be one way to discourage this behavior and lessen the trade distorting effect on unrelated industries.³⁰⁵ The creation and supervision of such a mechanism, while it would involve a more hands-on approach than the DSB has traditionally favored, is the best way to neutralize a situa-

296. WT/DS46/ARB, *supra* note 175, para. 2.14; *see also supra* note 181 and accompanying text.

297. *See* WT/DS46/ARB, *supra* note 175 (allowing extensive countermeasures not limited to the aircraft industry).

298. *Id.*

299. *See* Baglolo & Chipello, *supra* note 150, at A4 (showing that the parties were nearly in agreement before countermeasures were allowed).

300. *See* McArthur, *supra* note 247 (illustrating that Bombardier continued to use financing backed by the Canadian government); *see also* Scofield & Chase, *supra* note 261.

301. *See* McArthur, *supra* note 247; *see also* Scofield & Chase, *supra* note 261.

302. WT/DS46/ARB, *supra* note 175 (allowing for \$233.5 million (U.S.) in countermeasures).

303. *See* MacKinnon, *supra* note 209 and accompanying text.

304. *See* MacKinnon & McCarthy, *supra* note 211 and accompanying text.

305. WT/DS222/5, *supra* note 265, para. 7.174; *see also supra* note 268 and accompanying text.

tion where member states might otherwise compete with escalating levels of subsidization. Enactment of this mechanism would encourage compliance of both developed and developing countries.³⁰⁶ It would also force member states to compete by attempting to develop superior product.³⁰⁷

Third, it has become obvious that Article 27 of the SCM Agreement, which attempts to mitigate potential deleterious effects of the Agreement on developing nations, will be construed fairly narrowly.³⁰⁸ This is shown by the Panel's finding that Brazil's failure to phase-out its subsidy levels, having committed itself to issue new bonds after the end of the transition period, meant that it was not shielded by the SCM Agreement 27 exception.³⁰⁹ Brazil failed in its claim that the subsidy level at the date of creation of PROEX, 1991, was the appropriate benchmark for determining whether those levels had been increased. The Panel instead found that the date preceding enactment of the WTO Agreement was the relevant date.³¹⁰ The Panel also rejected the Brazilian argument that the subsidies were granted when the bonds, some of which were to be issued after the end of the transition period, were issued.³¹¹ This was probably an appropriate result since any precedent set with a less than strict interpretation of the developing country exception would only encourage developing countries to continue subsidizing and prolong dependency on those subsidies.³¹²

While this strict interpretation may correctly lessen the significant developing country dependence on such subsidies, it may produce tension.³¹³ After having negotiated for Article 27 phase-out relief for domestic political purposes, developing member states now found that Article 27 was not the hoped for escape hatch.³¹⁴ Developing nations have issues, which tend to be politically sensitive such as "Brazil Risk," that they feel are not adequately addressed by the SCM Agreement, which tend to

306. See *supra* note 268 and accompanying text.

307. See *supra* note 38 and accompanying text (showing that currently Canada and Brazil compete on economic factors such as subsidies and labor costs).

308. WT/DS46/R, *supra* note 42, paras. 7.83-7.85, 7.87-7.93 and accompanying text. See also WT/DS46/AB/R, *supra* note 89, para. 196(b) and accompanying text.

309. See *supra* note 47 and accompanying text.

310. WT/DS46/R, *supra* note 42, para. 7.61.

311. *Id.* para. 7.62.

312. *Id.*

313. WT/DS46/AB/R, *supra* note 89; see also *supra* note 90 and accompanying text.

314. Final Act, *supra* note 2, at art. 27.4.

be politically sensitive.³¹⁵ A failure to resolve the problem satisfactorily within the system will further exacerbate the current reluctance of many developing countries to move toward elimination of trade barriers.³¹⁶ In the jet dispute, Brazil clearly believes that it cannot compete effectively with Bombardier because of its lower cost of financing and alleged secretive subsidy programs, without implementing subsidy programs that violate the SCM Agreement.³¹⁷ Supervised subsidy matching and developing country participation in the setting of the export credit financing benchmark will encourage developing countries to believe that instead of having to “level the playing field” for themselves, they can rely on the WTO to do it for them.³¹⁸

A fourth problem exposed by the jet dispute is that member states with political sensitivities over a case brought against it in the DSB may attempt to neutralize its effect by bringing parallel cases against the original complaining party.³¹⁹ In the jet dispute, this strategy was successfully employed by Brazil.³²⁰ A situation which began with Canada complaining about Brazil's Embraer subsidies has changed radically and into one in which Brazil is currently awaiting the result of its request of \$3.36 billion (U.S.) in retaliatory measures against Canada.³²¹ In addition, frustrated complaining parties who have been successful in the DSB, without practical effect, may cause further trade-distorting effects by granting impermissible subsidies to their own domestic industry, even though this self-help form of “subsidy matching” has been expressly disapproved by the DSB.³²² After all, both Canada and Brazil claim to be merely matching illegal subsidies granted to the other's jet industry.³²³ Supervised subsidy matching would serve to lessen such unilateralism and gamesmanship.

The final serious problem the jet dispute has revealed is that parties to a dispute will try to avoid compliance by “restructuring” a subsidy program and continuing to grant subsidies

315. WT/DS46/R, *supra* note 42, paras. 4.128-4.143.

316. Chase, *supra* note 272 and accompanying text.

317. MacKinnon, *supra* note 9; see also *supra* note 50 and accompanying text.

318. Chase, *supra* note 257 and accompanying text (showing that Canada's goal was simply to match the subsidies given by Brazil).

319. See *supra* notes 87-88, 104 and accompanying text.

320. See *supra* note 47, 104 and accompanying text.

321. WTO Panel Report, *Canada - Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/7, (May 24, 2002), paras. 1-2, available at <http://www.wto.org> and 2002 WL 1046056.

322. See *supra* note 257 and accompanying text.

323. See *supra* note 257 and accompanying text.

under the “new” program, which they claim is compliant.³²⁴ In the jet dispute, both the PROEX program and a variety of Canadian subsidy programs clearly were subject to this kind of tinkering. To avoid this type of creative “restructuring,” a stricter standard needs to be imposed.³²⁵ This new standard must encourage complete removal of subsidy programs by allowing evidence of specific targeting of an export-oriented sector in one of these restructured programs.³²⁶ Coupled with evidence of prior prohibited use of the subsidy program from previous proceedings, this new standard would demonstrate prohibited export contingency in compliance proceedings.³²⁷ The burden should then shift to the member subsidizing those specific sectors to disprove the relationship of contingency or dependence of the subsidy to exports.³²⁸ Additionally, while the DSB has declined to give guidelines for implementation of its rulings, stating that is not its role, perhaps it needs to be given more of a role in that process. If it did have such a role, it might have shortened the length of the still existent jet dispute.

CONCLUSION

If an all-out trade war develops between Brazil and Canada, it would be another example of the failure of the system, the grand experiment with a binding system of international dispute resolution. Such a failure could even retard the evolution towards centralization of trade disputes in the WTO/GATT system. Therefore, the importance of the compliance issues raised by the Brazil-Canada jet dispute goes beyond the specific complaints raised in those proceedings and needs to be addressed. With reform, the WTO should be able to play a more effective role than it has to date in defusing tensions between member states over trade disputes, such as the regional jets case. If respect for the system was one issue in the beef and bananas disputes, it may be the most important issue in the Canada/Brazil jet subsidy wars.

324. See *supra* note 152 and accompanying text.

325. See *supra* notes 152, 165 and accompanying text (showing that Appellate Body focused on no new issues and declined to set general guidelines).

326. WT/DS46/R, *supra* note 42, para. 8.5.

327. See *supra* note 171 and accompanying text.

328. See *supra* note 160 and accompanying text.