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1 ANNEX 2

1.1 Text of Annex 2

Annex 2

Domestic Support: The Basis for Exemption from the Reduction Commitments

1. Domestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production. Accordingly, all measures for which exemption is claimed shall conform to the following basic criteria:

- (a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers; and,
- (b) the support in question shall not have the effect of providing price support to producers;

plus policy-specific criteria and conditions as set out below.

Government Service Programmes

2. General services

Policies in this category involve expenditures (or revenue foregone) in relation to programmes which provide services or benefits to agriculture or the rural community. They shall not involve direct payments to producers or processors. Such programmes, which include but are not restricted to the following list, shall meet the general criteria in paragraph 1 above and policy-specific conditions where set out below:

- (a) research, including general research, research in connection with environmental programmes, and research programmes relating to particular products;
- (b) pest and disease control, including general and product-specific pest and disease control measures, such as early-warning systems, quarantine and eradication;
- (c) training services, including both general and specialist training facilities;
- (d) extension and advisory services, including the provision of means to facilitate the transfer of information and the results of research to producers and consumers;
- (e) inspection services, including general inspection services and the inspection of particular products for health, safety, grading or standardization purposes;

- (f) marketing and promotion services, including market information, advice and promotion relating to particular products but excluding expenditure for unspecified purposes that could be used by sellers to reduce their selling price or confer a direct economic benefit to purchasers; and
- (g) infrastructural services, including: electricity reticulation, roads and other means of transport, market and port facilities, water supply facilities, dams and drainage schemes, and infrastructural works associated with environmental programmes. In all cases the expenditure shall be directed to the provision or construction of capital works only, and shall exclude the subsidized provision of on-farm facilities other than for the reticulation of generally available public utilities. It shall not include subsidies to inputs or operating costs, or preferential user charges.

3. Public stockholding for food security purposes⁵

*(footnote original)*⁵ For the purposes of paragraph 3 of this Annex, governmental stockholding programmes for food security purposes in developing countries whose operation is transparent and conducted in accordance with officially published objective criteria or guidelines shall be considered to be in conformity with the provisions of this paragraph, including programmes under which stocks of foodstuffs for food security purposes are acquired and released at administered prices, provided that the difference between the acquisition price and the external reference price is accounted for in the AMS.

Expenditures (or revenue foregone) in relation to the accumulation and holding of stocks of products which form an integral part of a food security programme identified in national legislation. This may include government aid to private storage of products as part of such a programme.

The volume and accumulation of such stocks shall correspond to predetermined targets related solely to food security. The process of stock accumulation and disposal shall be financially transparent. Food purchases by the government shall be made at current market prices and sales from food security stocks shall be made at no less than the current domestic market price for the product and quality in question.

4. Domestic food aid⁶

(footnote original)^{5 & 6} For the purposes of paragraphs 3 and 4 of this Annex, the provision of foodstuffs at subsidized prices with the objective of meeting food requirements of urban and rural poor in developing countries on a regular basis at reasonable prices shall be considered to be in conformity with the provisions of this paragraph.

Expenditures (or revenue foregone) in relation to the provision of domestic food aid to sections of the population in need.

Eligibility to receive the food aid shall be subject to clearly-defined criteria related to nutritional objectives. Such aid shall be in the form of direct provision of food to those concerned or the provision of means to allow eligible recipients to buy food either at market or at subsidized prices. Food purchases by the government shall be made at current market prices and the financing and administration of the aid shall be transparent.

5. Direct payments to producers

Support provided through direct payments (or revenue foregone, including payments in kind) to producers for which exemption from reduction commitments is claimed shall meet the basic criteria set out in paragraph 1 above, plus specific criteria applying to individual types of direct payment as set out in paragraphs 6 through 13 below. Where exemption from reduction is claimed for any existing or new type of direct payment other than those specified in paragraphs 6 through 13, it shall conform to criteria (b) through (e) in paragraph 6, in addition to the general criteria set out in paragraph 1.

6. Decoupled income support

- (a) Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period.
- (b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.
- (c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.
- (d) The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period.
- (e) No production shall be required in order to receive such payments.

7. Government financial participation in income insurance and income safety-net programmes

- (a) Eligibility for such payments shall be determined by an income loss, taking into account only income derived from agriculture, which exceeds 30 per cent of average gross income or the equivalent in net income terms (excluding any payments from the same or similar schemes) in the preceding three-year period or a three-year average based on the preceding five-year period, excluding the highest and the lowest entry. Any producer meeting this condition shall be eligible to receive the payments.
- (b) The amount of such payments shall compensate for less than 70 per cent of the producer's income loss in the year the producer becomes eligible to receive this assistance.
- (c) The amount of any such payments shall relate solely to income; it shall not relate to the type or volume of production (including livestock units) undertaken by the producer; or to the prices, domestic or international, applying to such production; or to the factors of production employed.
- (d) Where a producer receives in the same year payments under this paragraph and under paragraph 8 (relief from natural disasters), the total of such payments shall be less than 100 per cent of the producer's total loss.

8. Payments (made either directly or by way of government financial participation in crop insurance schemes) for relief from natural disasters

- (a) Eligibility for such payments shall arise only following a formal recognition by government authorities that a natural or like disaster (including disease outbreaks, pest infestations, nuclear accidents, and war on the territory of the Member concerned) has occurred or is occurring; and shall be determined by a production loss which exceeds 30 per cent of the average of production in the preceding three-year period or a three-year average based on the preceding five-year period, excluding the highest and the lowest entry.
- (b) Payments made following a disaster shall be applied only in respect of losses of income, livestock (including payments in connection with the veterinary treatment of animals), land or other production factors due to the natural disaster in question.

- (c) Payments shall compensate for not more than the total cost of replacing such losses and shall not require or specify the type or quantity of future production.
 - (d) Payments made during a disaster shall not exceed the level required to prevent or alleviate further loss as defined in criterion (b) above.
 - (e) Where a producer receives in the same year payments under this paragraph and under paragraph 7 (income insurance and income safety--net programmes), the total of such payments shall be less than 100 per cent of the producer's total loss.
9. Structural adjustment assistance provided through producer retirement programmes
- (a) Eligibility for such payments shall be determined by reference to clearly defined criteria in programmes designed to facilitate the retirement of persons engaged in marketable agricultural production, or their movement to non-agricultural activities.
 - (b) Payments shall be conditional upon the total and permanent retirement of the recipients from marketable agricultural production.
10. Structural adjustment assistance provided through resource retirement programmes
- (a) Eligibility for such payments shall be determined by reference to clearly defined criteria in programmes designed to remove land or other resources, including livestock, from marketable agricultural production.
 - (b) Payments shall be conditional upon the retirement of land from marketable agricultural production for a minimum of three years, and in the case of livestock on its slaughter or definitive permanent disposal.
 - (c) Payments shall not require or specify any alternative use for such land or other resources which involves the production of marketable agricultural products.
 - (d) Payments shall not be related to either the type or quantity of production or to the prices, domestic or international, applying to production undertaken using the land or other resources remaining in production.
11. Structural adjustment assistance provided through investment aids
- (a) Eligibility for such payments shall be determined by reference to clearly-defined criteria in government programmes designed to assist the financial or physical restructuring of a producer's operations in response to objectively demonstrated structural disadvantages. Eligibility for such programmes may also be based on a clearly-defined government programme for the reprivatization of agricultural land.
 - (b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period other than as provided for under criterion (e) below.
 - (c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.
 - (d) The payments shall be given only for the period of time necessary for the realization of the investment in respect of which they are provided.

- (e) The payments shall not mandate or in any way designate the agricultural products to be produced by the recipients except to require them not to produce a particular product.
- (f) The payments shall be limited to the amount required to compensate for the structural disadvantage.

12. Payments under environmental programmes

- (a) Eligibility for such payments shall be determined as part of a clearly-defined government environmental or conservation programme and be dependent on the fulfilment of specific conditions under the government programme, including conditions related to production methods or inputs.
- (b) The amount of payment shall be limited to the extra costs or loss of income involved in complying with the government programme.

13. Payments under regional assistance programmes

- (a) Eligibility for such payments shall be limited to producers in disadvantaged regions. Each such region must be a clearly designated contiguous geographical area with a definable economic and administrative identity, considered as disadvantaged on the basis of neutral and objective criteria clearly spelt out in law or regulation and indicating that the region's difficulties arise out of more than temporary circumstances.
- (b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period other than to reduce that production.
- (c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.
- (d) Payments shall be available only to producers in eligible regions, but generally available to all producers within such regions.
- (e) Where related to production factors, payments shall be made at a degressive rate above a threshold level of the factor concerned.
- (f) The payments shall be limited to the extra costs or loss of income involved in undertaking agricultural production in the prescribed area.

1.2 Paragraph 6 of Annex 2

1.2.1 Subparagraph (b)

1. In *US – Upland Cotton*, the Appellate Body upheld the Panel's finding in relation to Article 13(b)(ii) that payments under two United States domestic support programmes were non-green box measures because they did not fully conform with paragraph 6(b) of Annex 2 due to a partial exclusion of certain types of production. The programmes imposed no positive obligation to produce particular crops, indeed, they imposed no obligation to produce at all. However, payments under the programmes were reduced or eliminated when the recipients planted any of a list of excluded crops. The Panel and the Appellate Body found that, as a result, the amount of such payments was related to the type of production in years after the base year, inconsistently with paragraph 6(b) of Annex 2:

"The ordinary meaning of the term 'related to' in paragraph 6(b) of Annex 2 denotes some degree of relationship or connection between two things, here the amount of payment, on the one hand, and the type or volume of production, on the other. It covers a broader set of connections than 'based on', which term is also used to

describe the relationship between two things covered by paragraph 6(b). [original footnote omitted] Nothing in the ordinary meaning of the term 'related to' suggests that the connections covered by this expression may not encompass connections of either a 'positive' nature (including directions or requirements to do something) or a 'negative' nature (including prohibitions or requirements not to do something) or a combination of both. As the Panel indicated, the ordinary meaning of the term 'related to' conveys 'a very general notion'. Indeed, the United States agrees that, as far as its ordinary meaning in the abstract is concerned, the term 'related to' may be broad enough to capture both positive and negative connections, but argues that the context of paragraph 6(b) requires a more limited interpretation of the term, namely, only as covering a 'positive' connection between the 'amount of ... payments' and the 'type ... of production'. Like the Panel, however, we are of the view that, in the context of paragraph 6(b), the term 'related to' covers both positive and negative connections between the amount of payment and the type of production.

...

We agree with the Panel that a partial exclusion of some crops from payments has the potential to channel production towards the production of crops that remain eligible for payments. In contrast to a total production ban, the channelling of production that may follow from a partial exclusion of some crops from payments will have positive production effects as regards crops eligible for payments. The extent of this will depend on the scope of the exclusion. We note in this regard that the Panel found, as a matter of fact, that planting flexibility limitations at issue in this case 'significantly constrain production choices available to PFC and DP payment recipients and effectively eliminate a significant proportion of them'. The fact that farmers may continue to receive payments if they produce nothing at all does not detract from this assessment because, according to the Panel, it is not the option preferred by the 'overwhelming majority' of farmers, who continue to produce some type of permitted crop. In the light of these findings by the Panel, we are unable to agree with the United States' argument that the planting flexibility limitations only negatively affect the production of crops that are excluded."¹

2. In *US – Upland Cotton*, the Appellate Body rejected arguments that the terms "amount of such payments" and "undertaken" as used in paragraph 6(b) of Annex 2 could not refer to crops not eligible for payment or to crops not planted:

"In our view, the concepts of 'type or volume of production ... undertaken by the producer' and the 'amount of ... payments' are linked in paragraph 6(b) by the requirement that one 'not be related to' the other. This requires a consideration of the relationship between the type or volume of production and the amount of payment under a program after the base period. A program that disallows payments when certain crops are produced relates the amount of the payment to the type of production undertaken. The flexibility to produce and receive payment for certain crops covered by a program, combined with the reduction or elimination of such payments when excluded crops are produced, creates a link with the type of production undertaken contrary to paragraph 6(b). This is so because the opportunity for farmers to receive payments for producing covered crops, while less or no such payments are made to farmers who produce excluded crops, provides an incentive to switch from producing excluded crops to producing crops eligible for payments."²

1.2.2 Subparagraph (e)

3. In *US – Upland Cotton*, the Appellate Body confirmed that subparagraph (e) served a distinct purpose from subparagraph (b) within paragraph 6:

"In our view, however, paragraph 6(e) continues to serve a purpose distinct from that of paragraph 6(b). It highlights a different aspect of decoupling income support. In prohibiting Members from making green-box measures contingent on

¹ Appellate Body Report, *US – Upland Cotton*, paras. 324 and 329.

² Appellate Body Report, *US – Upland Cotton*, para. 331.

production, paragraph 6(e) implies that Members are allowed, in principle, to require no production at all. Accordingly, payments conditioned on a total ban on any production may qualify as decoupled income support under paragraph 6(e). Even assuming that payments contingent on a total production ban could be seen to relate the amount of the payment to the volume of production within the meaning of paragraph 6(b)—the volume of production being nil—giving meaning and effect to both paragraphs 6(b) and 6(e) suggests a reading of paragraph 6(b) that would not disallow a total ban on any production."³

1.2.3 Relationship with other provisions of the Agreement on Agriculture

4. In *US – Upland Cotton*, the Appellate Body gave considerable weight in its interpretation of paragraph 6(b) of Annex 2 to the context provided by paragraph 11 of Annex 2, which indicated that the ordinary meaning of the terms used in paragraph 6(b) did not authorize a negative requirement not to produce a particular product:

"We find further support for our interpretation of paragraph 6(b) in the context provided by paragraph 11 of Annex 2, entitled 'Structural adjustment assistance provided through investment aids'. Several of the subparagraphs of paragraph 11 are phrased in similar terms to those of paragraph 6. Indeed, like paragraph 6(b), paragraph 11(b) requires that the 'amount of ... payments ... shall not be related to ... the type or volume of production ... undertaken by the producer in any year after the base period.' However, unlike paragraph 6(b), paragraph 11(b) ends with the phrase 'other than as provided for under criterion (e) below'. Criterion 11(e) specifically envisages that 'payments shall not mandate or in any way designate the agricultural products to be produced by the recipients except to require them not to produce a particular product'.

We note that the exception provided by paragraph 11(e) and the link to paragraph 11(e) in paragraph 11(b) explicitly authorize the type of 'negative' requirements not to produce that the United States argues is implicitly permitted by the terms of paragraph 6(b). In the light of the similarity of the language chosen in paragraphs 6(b) and 11(b), like the Panel, we attach significance to the fact that the drafters saw as necessary an explicit authorization of negative requirements not to produce under paragraph 11(b). In our view, this indicates that the ordinary meaning of the terms in paragraph 11(b) would otherwise exclude an interpretation allowing such negative requirements. The use of identical language in paragraphs 6(b) and 11(b), except for the reference in paragraph 11(b) to paragraph 11(e), suggests that the meaning of the terms in paragraph 6(b) must be the same as in paragraph 11(b). Accordingly, a comparison of these provisions confirms that the terms of paragraph 6(b) encompass both positive as well as negative connections between the amount of payments under a program and the type of production undertaken."⁴

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³ Appellate Body Report, *US – Upland Cotton*, para. 327.

⁴ Appellate Body Report, *US – Upland Cotton*, paras. 335-336.