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**1 ANNEX 3**

**1.1 Text of Annex 3**

**Annex 3**

*Domestic Support: Calculation of Aggregate Measurement of Support*

1. Subject to the provisions of Article 6, an Aggregate Measurement of Support (AMS) shall be calculated on a product-specific basis for each basic agricultural product receiving market price support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment ("other non-exempt policies"). Support which is non-product specific shall be totalled into one non-product-specific AMS in total monetary terms.
2. Subsidies under paragraph 1 shall include both budgetary outlays and revenue foregone by governments or their agents.
3. Support at both the national and sub-national level shall be included.
4. Specific agricultural levies or fees paid by producers shall be deducted from the AMS.
5. The AMS calculated as outlined below for the base period shall constitute the base level for the implementation of the reduction commitment on domestic support.
6. For each basic agricultural product, a specific AMS shall be established, expressed in total monetary value terms.
7. The AMS shall be calculated as close as practicable to the point of first sale of the basic agricultural product concerned. Measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products.
8. Market price support: market price support shall be calculated using the gap between a fixed external reference price and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price. Budgetary payments made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS.

9. The fixed external reference price shall be based on the years 1986 to 1988 and shall generally be the average f.o.b. unit value for the basic agricultural product concerned in a net exporting country and the average c.i.f. unit value for the basic agricultural product concerned in a net importing country in the base period. The fixed reference price may be adjusted for quality differences as necessary.

10. Non-exempt direct payments: non-exempt direct payments which are dependent on a price gap shall be calculated either using the gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price, or using budgetary outlays.

11. The fixed reference price shall be based on the years 1986 to 1988 and shall generally be the actual price used for determining payment rates.

12. Non-exempt direct payments which are based on factors other than price shall be measured using budgetary outlays.

13. Other non-exempt measures, including input subsidies and other measures such as marketing-cost reduction measures: the value of such measures shall be measured using government budgetary outlays or, where the use of budgetary outlays does not reflect the full extent of the subsidy concerned, the basis for calculating the subsidy shall be the gap between the price of the subsidized good or service and a representative market price for a similar good or service multiplied by the quantity of the good or service.

## 1.2 General

1. The Panel in *Korea – Various Measures on Beef*, in a finding later reversed by the Appellate Body,<sup>1</sup> agreed with the complainants that Korea had provided domestic support to its beef industry in excess of its commitment levels for 1997 and 1998. In its notifications, Korea had determined that its Current AMS for beef was below the *de minimis* threshold as set out in Article 6.4; as a result, Korea argued, this domestic support item did not have to be included in the calculation of its Current Total AMS. The Panel found that Korea's calculations in this respect were in error. Korea argued that its calculation was correct, because it was based on the "constituent data and methodology" used in its Schedule, in accordance with Articles 1(a)(ii) and 1(h)(ii) of the Agreement on Agriculture. The Appellate Body, with respect to the calculation of the Current AMS, first recalled the wording of Article 1(a)(ii) of the Agreement on Agriculture which contains the definition of the term "Current AMS", stating:

"To determine whether Korea's Current AMS for beef exceeds 10 per cent of total value of beef production, we refer again to Article 1(a)(ii) of the *Agreement on Agriculture*, which defines Current AMS. Under this provision, Current AMS is to be

calculated *in accordance with* the provisions of Annex 3 of this Agreement and *taking into account* the constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member's Schedule; ... (emphasis added)

Article 1(a)(ii) contains two express requirements for calculating Current AMS. First, Current AMS is to be 'calculated *in accordance with* the provisions of Annex 3 of this Agreement'. The ordinary meaning of 'accordance' is 'agreement, conformity, harmony'. Thus, Current AMS must be calculated in 'conformity' with the provisions of Annex 3. Second, Article 1(a)(ii) provides that the calculation of Current AMS is to be made while 'taking into account the constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member's Schedule.' 'Take into account' is defined as 'take into consideration, notice'. Thus, when Current AMS is calculated, the 'constituent data and methodology' in a Member's Schedule must be 'taken into account', that is, it must be 'considered'.<sup>2</sup>

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<sup>1</sup> See Appellate Body Report, *Korea – Various Measures on Beef*, paras. 126-127 and 129.

<sup>2</sup> Appellate Body Report, *Korea – Various Measures on Beef*, para. 111.

2. The Appellate Body then held that Article 1(a)(ii) accorded "higher priority" to the provisions of Annex 3 than to "constituent data and methodology" contained in a Member's Schedule, but as Korea had no specific "constituent data and methodology" for beef, its Current AMS for beef was to be calculated in accordance with the provisions of Annex 3:

"Looking at the wording of Article 1(a)(ii) itself, it seems to us that this provision attributes higher priority to 'the provisions of Annex 3' than to the 'constituent data and methodology'. From the viewpoint of ordinary meaning, the term 'in accordance with' reflects a more rigorous standard than the term 'taking into account'.

We note, however, that the Panel did not base its reasoning on this apparent hierarchy as between 'the provisions of Annex 3' and the 'constituent data and methodology'.<sup>3</sup> Instead, the Panel considered that where no support was included in the base period calculation for a given product, there is no 'constituent data or methodology' to refer to, so that the only means available for calculating domestic support is that provided in Annex 3. As beef had not been included in Supporting Table 6 of Korea's Schedule LX, Part IV, Section I, the Panel concluded that Annex 3 alone is applicable for the purposes of calculating current non-exempt support in respect of Korean beef.

In the circumstances of the present case, it is not necessary to decide how a conflict between 'the provisions of Annex 3' and the 'constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member's Schedule' would have to be resolved in principle. As the Panel has found, in this case, there simply are no constituent data and methodology for beef.<sup>4</sup> Assuming *arguendo* that one would be justified – in spite of the wording of Article 1(a)(ii) – to give priority to constituent data and methodology used in the tables of supporting material over the guidance of Annex 3, for products entering into the calculation of the Base Total AMS, such a step would seem to us to be unwarranted in calculating Current AMS for a product which did *not* enter into the Base Total AMS calculation. We do not believe that the *Agreement on Agriculture* would sustain such an extrapolation. We, therefore, agree with the Panel that, in this case, Current AMS for beef has to be calculated in accordance with the provisions of Annex 3, and with these provisions alone."<sup>5</sup>

3. In *Korea – Various Measures on Beef*, the Panel also held that Korea had miscalculated its Current AMS for beef on the basis of a fixed external reference price for the period 1989-1991, rather than the period 1986-88, as set forth in paragraph 9 of Annex 3. Korea argued that its use of the period 1989-1991 was justified, because this period was referred to in the constituent data and methodology (used with respect to products other than beef) contained in a table of supporting material incorporated in its Schedule. The Appellate Body agreed with the Panel and recalled its findings referenced in paragraph 2 above:

"The Panel found that in both 1997 and 1998 Korea miscalculated its fixed external reference price, contrary to Article 6 and paragraph 9 of Annex 3, by using a fixed external reference price based on data for 1989-1991. Korea justifies this choice by invoking the 'constituent data and methodology' used in its Supporting Table 6 for all products other than rice, i.e., for barley, soybean, maize (corn) and rape seeds. In Supporting Table 6, all these products use the period 1989-1991 for the fixed external reference price.

We have already explained above that we share the Panel's view with respect to Korea's argument on 'constituent data and methodology' used in the table of supporting material. We agree with the Panel that, in this case, Current AMS for beef

<sup>3</sup> (*footnote original*) On the contrary, the Panel opines that the "constituent data and methodology" has an important role to play in ensuring that the calculation of support to any given product is calculated in subsequent years consistently with support calculated in the base period. Panel Report, para. 811.

<sup>4</sup> (*footnote original*) In other words, there is no *data* (product) in respect of which the *methodology* of Schedule LX of Korea (that is, the use of figures for the years 1989-1991) could be applied, in so far as beef is concerned.

<sup>5</sup> Appellate Body Report, *Korea – Various Measures on Beef*, paras. 112-114.

has to be calculated in accordance with Annex 3. According to Annex 3, '[t]he fixed external reference price shall be based on the years 1986 to 1988'. We, therefore, also agree with the Panel that in calculating the product specific AMS for beef for the years 1997 and 1998, Korea should have used an external reference price based on data for 1986-1988, instead of data for 1989-1991."<sup>6</sup>

4. In a finding not challenged on appeal, the Panel in *US – Upland Cotton* sought guidance in the guidelines for calculating Aggregate Measure of Support (AMS) set out in Annex 3 to calculate the support granted or decided under Article 13(b)(ii). Ultimately, in the circumstances of the dispute, it was not necessary for the Panel to choose between price gap or budgetary outlay methodologies to calculate direct payments dependent on a price gap.<sup>7</sup>

5. The Panel in *China – Agricultural Producers* underlined the similarities in the calculation processes of Base Total AMS and Current Total AMS, and stated that such similarities should be taken into account in making calculations:

"In conclusion, we find that while Article 1 does not contain guidance on how to calculate the Base Total AMS, Paragraph 5 of Annex 3 does set out important rules in this regard. Importantly, Paragraphs 6-13 of Annex 3 are also applicable to the calculation of the Current Total AMS. This implies that as per the Agreement on Agriculture, the calculation processes of both the Base Total and current AMS are similar. This similarity gives strong support to the notion that there must be consistency in the way these measurements of domestic support are calculated. Importantly, we are of the view that failing to recognize that the Agreement on Agriculture provides for a similar calculation process for both types of measurements might end up in a comparison between apples and oranges, as China suggests."<sup>8</sup>

### 1.3 Paragraph 7

6. With respect to the issue of whether paragraph 7 of Annex 3 of the Agreement on Agriculture is a specific provision dealing specifically with the same matter as Article 3.1(b) of the SCM Agreement and in particular, whether Article 3.1(b) of the SCM Agreement applies to agricultural products, see the Section on Article 3.1(b) of the SCM Agreement.

#### 1.3.1 "point of first sale"

7. The Panel in *China – Agricultural Producers* clarified the meaning of "point of first sale" as follows:

"We believe that the relevant point of first sale of the basic agricultural product would be the point at which Chinese *producers* of rice in the relevant provinces sell their product to the government or its relevant purchasing entities. This is because, as outlined in Paragraph 7 of Annex 3, the calculation of AMS is aimed at assessing measures which benefit producers of basic agricultural products. In other words, it is the point at which the measure acts to benefit the producers that is relevant here (that is, the point at which the rice producers sell their rice at the AAP). In addition, the plain meaning of 'point of first sale' indicates that AMS is to be calculated in relation to the first instance the commodity is sold. The price at the point of first sale for rice would be the 'farm-gate', 'paddy' or 'unmilled' price of both Indica and Japonica rice."<sup>9</sup>

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<sup>6</sup> Appellate Body Report, *Korea – Various Measures on Beef*, paras. 117-118.

<sup>7</sup> Panel Report, *US – Upland Cotton*, paras. 7.552 and 7.554.

<sup>8</sup> Panel Report, *China – Agricultural Producers*, para. 7.233. See also *ibid.* paras. 7.243-7.244 and 7.251.

<sup>9</sup> Panel Report, *China – Agricultural Producers*, para. 7.341.

## **1.4 Paragraph 8**

### **1.4.1 General**

8. In *China – GOES*, the Panel used the concept of "market price support" as included in paragraph 8 of Annex 3 of the Agreement on Agriculture as relevant context for interpreting the term "price support" under Article 1.1(a)(2) of the SCM Agreement:

"Annex 3 of that Agreement provides that 'market price support' is calculated as the difference between an external reference price and the 'applied administered price'. This indicates, at least for the type of price support contemplated in Annex 3 of the *Agreement on Agriculture*, that a direct form of government control over domestic prices is required, in the form of a fixed, administered price, rather than a movement in prices being an indirect effect of another form of government intervention."<sup>10</sup>

### **1.4.2 "applied administered price" (APP)**

9. The Panel in *China – Agricultural Producers* defined the APP as "the price set by the government at which specified entities will purchase certain basic agricultural products."<sup>11</sup>

### **1.4.3 "to receive the applied administered price" (AAP)**

10. The Panel in *China – Agricultural Producers* found that "the quantity of production eligible to receive the AAP refers to the amount of production of a product which is fit, or able to benefit from the price support provided through the AAP."<sup>12</sup>

### **1.4.4 "quantity of production eligible" (QEP)**

11. In *Korea – Various Measures on Beef*, the Appellate Body agreed with the Panel that in determining its market price support for beef, Korea had used the quantity of cattle actually purchased, in contravention of paragraph 8 of Annex 3. The Appellate Body stated:

"We share the Panel's view that the words 'production *eligible* to receive the applied administered price' in paragraph 8 of Annex 3 have a different meaning in ordinary usage from 'production *actually purchased*'. The ordinary meaning of 'eligible' is 'fit or *entitled* to be chosen'. Thus, 'production eligible' refers to production that is 'fit or entitled' to be purchased rather than production that was actually purchased. In establishing its program for future market price support, a government is able to define and to limit 'eligible' production. Production actually purchased may often be less than eligible production."<sup>13</sup>

12. The Panel in *China – Agricultural Producers* stated that the quantity of production eligible should be determined as follows:

"We agree with China that a panel must consider the CDM in a Member's supporting tables when calculating the AMS. This, however, does not mean that any reference to eligible production contained in the tables of supporting material should necessarily be regarded as the definition of 'quantity of production eligible' within the meaning of Paragraph 8 of Annex 3. As noted above, the QEP is informed by the operation of the challenged measures, which would be reflected in the calculation of the AMS. To us, this understanding of the QEP is consistent with Articles 1(a)(ii) and 1(h)(ii) of the Agreement on Agriculture. Contrary to what China appears to be suggesting, the language of these provisions, requiring that AMS be calculated either taking into account, or in accordance with, the CDM, does not imply that all components of the

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<sup>10</sup> Panel Report, *China – GOES*, para. 7.87.

<sup>11</sup> Panel Report, *China – Agricultural Producers*, para. 7.177.

<sup>12</sup> Panel Report, *China – Agricultural Producers*, para. 7.283.

<sup>13</sup> Appellate Body Report, *Korea – Various Measures on Beef*, para. 120.

calculation are necessarily determined by the CDM contained in the tables of supporting material."<sup>14</sup>

## 1.5 Paragraph 9

### 1.5.1 "base period"

13. The Panel in *China – Agricultural Producers* clarified the meaning of "base period" as follows:

"We recall that the text of Paragraph 9 of Annex 3 explicitly refers to a particular time period. However, these elements need to be interpreted in the context provided by other provisions of the Agreement on Agriculture. Paragraph 5 of Annex 3, indicating that the Base Total AMS should be calculated using the guidance of Paragraphs 6-13, is of particular relevance here. As we noted in section 7.4.5.2.2 above, we came to the factual conclusion that none of the 36 Members that have acceded to the WTO since 1995 have used a period of 1986-88, with three exceptions. This is important because, as per Paragraph 5 of Annex 3, Paragraph 9 is meant to provide guidance for the calculation of the FERP for the purposes of determining Base Total AMS. However, and even in the face of this explicit guidance in Paragraph 5, the Base Total AMS of the referred Members did not use the time-period set out in Paragraph 9. The context provided by Paragraph 5, in conjunction with the above considerations, suggests that the time-period mentioned in this provision does not necessarily accommodate or envisage situations such as China's in this case, where the FERP used for the Base Total AMS was not anchored in the 1986-1988 period.

In addition, we note that the fact that the time-period set out in Paragraph 9 has not been used in the tables of supporting material of non-original Members provides useful context, on its own, for the interpretation of Paragraph 9. This is a consequence of the fact that the Base Total AMS, and most of the calculations necessary to produce it, are contained in the Members' tables of supporting material."<sup>15</sup>

### 1.5.2 "fixed external reference price" (FERP)

14. The Panel in *China – Agricultural Producers* pointed out that the same time period should be used to calculate Current Total AMS and Base Total AMS:

"Indeed, we note that of the three components of the MPS formula, the only one that does not measure a contemporaneous feature of the market is the FERP, as it is an *external reference price* that is anchored in a specific time-period. In other words, while the AAP and the QEP are variables that may evolve depending on the regulatory framework and the time-period for which the AMS is being measured, the FERP is the only part of the MPS formula that will remain the same, regardless of the period for which the domestic support is being measured. In this way, the FERP is more akin to a constant than to a variable.

Recognizing that the FERP will not change regardless of the year takes us to the source of a material incongruence that may arise when comparing Base Total and Current Total AMS in the process of assessing a Member's compliance with its domestic support commitments. Simply put, using one time-period for the FERP used in the Base Total AMS and another for the Current Total AMS would yield two different results in the MPS formula that would be entirely uncorrelated to changes in the actual provision of domestic support by a Member. There would thus be different results in these two measurements, even if the values for the AAP and the QEP were the same.

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<sup>14</sup> Panel Report, *China – Agricultural Producers*, para. 7.288. See also *ibid.* paras. 7.295-7.296.

<sup>15</sup> Panel Report, *China – Agricultural Producers*, paras. 7.262-7.263.

The above leads us to conclude that allowing the use of a different time-period in the FERP used to calculate Current Total AMS, as compared to the one used for the Base Total AMS would potentially entail an apples-to-oranges comparison, which would go very much against the broad correspondence that should exist in the calculation process of both measurements."<sup>16</sup>

### **1.5.3 "average f.o.b. unit"**

15. With regard to the reference to the average f.o.b. unit, in Paragraph 9 of Annex 3, the Panel in *China – Agricultural Producers* considered that:

"[T]he reference in Paragraph 9 of Annex 3 to 'the average f.o.b. unit value for the basic agricultural product concerned ...' requires that the AAP and the FERP must both be for the 'basic agricultural product'. This reasoning is reinforced by Paragraph 7, discussed further below, which states that AMS 'shall be calculated as close as practicable to the point of first sale of the basic agricultural product concerned'. "<sup>17</sup>

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<sup>16</sup> Panel Report, *China – Agricultural Producers*, paras. 7.268-7.269 and 7.271.

<sup>17</sup> Panel Report, *China – Agricultural Producers*, para. 7.332.