Factual Summary of the U.S. Crop Insurance Program

1. Under the Crop Insurance Program, the United States subsidizes insurance covering production and income for domestic agricultural producers. The United States has notified an average of $1,890 million annual net government budgetary outlays for the Crop Insurance Program during the years at issue.[1] Review of the average net government budgetary outlays during these years were almost double that -- $3,266 million.[2]

2. The Crop Insurance Program involves four different, integrated components which collectively enable the provision of low premium rates to U.S. farmers. The United States has notified support under two components of the program ("indemnities" and "premium subsidies") as part of its "Non-Product Specific AMS".[3] However, the U.S. notifications omit budgetary outlays for two additional components ("underwriting gains" and "cost allowances") of the overall program. These components, amounting to more than $1 billion annually, represent on average more than 40 per cent of domestic support under the Crop Insurance Program.[4] The importance of these two omitted outlays has increased significantly in recent years, as illustrated in the graph below.

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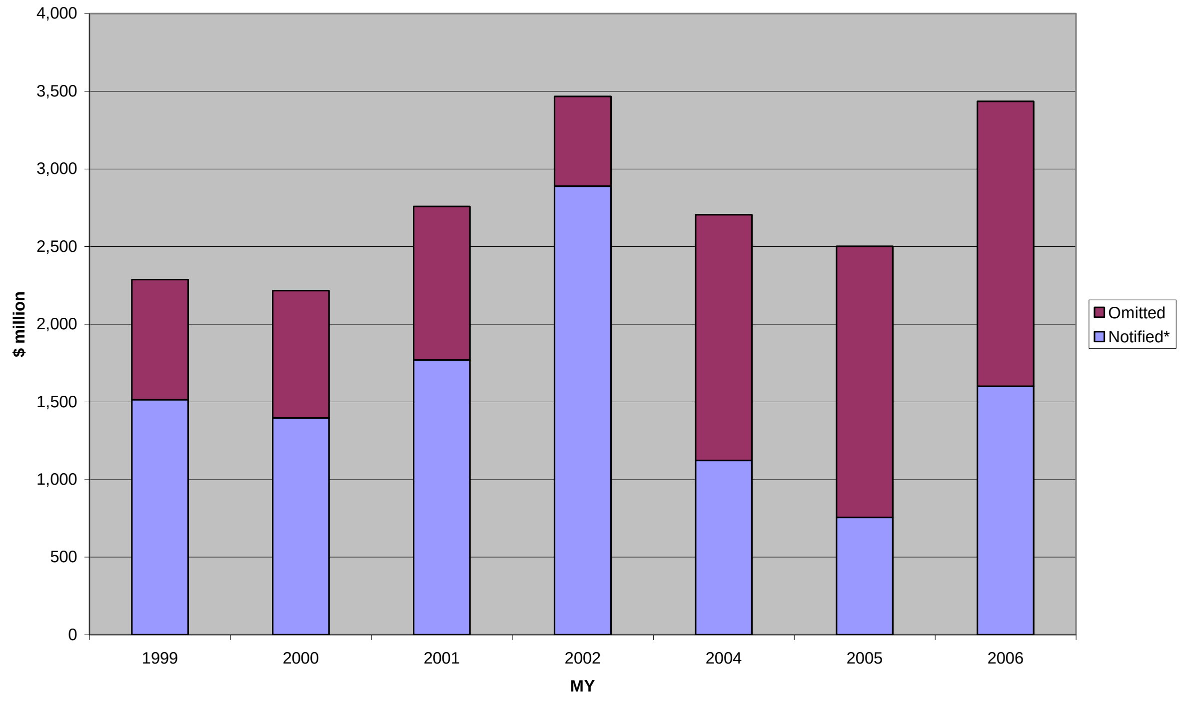
[1] Average of the difference between "Non-product-specific budgetary outlays" and "Associated fees/levies" for years 1999, 2000, 2001, 2002, 2004 and 2005 in documents G/AG/N/USA/60, pp. 27, 80 and 106; G/AG/N/USA/51, pp. 38 and 77; G/AG/N/USA/43, p. 36.

[2] [reference to detailed calculation]

[3] *See e.g.* G/AG/N/USA/60, p. 27.

[4] *See* GAO Testimony, "Crop Insurance – Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable," 7 June 2007, at www.gao.gov/new.items/d07944t.pdf, p. 14. *See also* Table 1 below: in the years covered by this dispute, the sum of cost allowances and underwriting gains represents, on average, 40 per cent of the total government budgetary outlays, *i.e.* $1,081 million.

Chart A.[5]



3. The facts related to the wo omitted insurance program components are discussed below. In addition, the records of the U.S. Government agency that administers the Crop Insurance Program show that the United States has somewhat underreported the budgetary outlays for the two program components that it has notified.[6]

Description of the U.S. Crop Insurance Program

4. Through the Crop Insurance Program, the United States subsidizes crop insurance for domestic agricultural producers.[7] The program provides two essential benefits to

[5] * "Notified", for marketing years 1999 to 2005: the net outlays as notified in the US Notifications to the WTO for marketing year 1999 (G/AG/N/USA/43, p. 36), 2000 and 2001 (G/AG/N/USA/51, pp. 38 and 77), 2002, 2004 and 2005 (G/AG/N/USA/60, pp. 27, 80 and 106).
* "Notified", for marketing year 2006: the United States has not yet notified its domestic support. Therefore, in this chart, an "estimate" notified amount for marketing year 2006. This amount could be determined by applying the methodology used by the United States in its earlier notifications (Indemnities + Premium Subsidy – Total Premiums), to the marketing year 2006 data from the RMA database, accessed at http://www3.rma.usda.gov/apps/sob/crop.cfm.
"Omitted": the sum of the omitted underwriting gains or losses, and cost allowances, as reported in GAO Testimony, "Crop Insurance - Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable," 7 June 2007, p. 14.
[6] [Reference to replica of US notification using RMA data]
[7] The subsidized insurance is either yield- or revenue-based. *See* Congressional Research Service Report for Congress, No. RL30739, "Federal Crop Insurance and the Agriculture Risk Protection Act of 2000 (P.L. 106-224)," 13 November 2000; GAO Testimony, "Crop Insurance – Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable," 7 June 2007, at www.gao.gov/new.items/d07944t.pdf, accessed 1 February 2008; Economic Research Service/USDA, Agricultural Outlook/August 1999, "Crop and Revenue Insurance: Bargain Rates but Still a Hard Sell", p. 16; and Economic Research Service/USDA Agricultural Outlook 1999, "Recent Developments in Crop Yield &

agricultural producers in the United States: (i) below-market premiums for crop insurance; and (ii) crop insurance coverage irrespective of the risk this entails.

5. The Crop Insurance Program is administered by the USDA's Risk Management Agency (RMA), through the Federal Crop Insurance Corporation (FCIC), also a USDA agency. These two USDA agencies deliver the benefits of the program to farmers through a partnership with approved private insurance companies (the Companies).[8] The U.S. Government, through the RMA and FCIC, sets, or approves, the premium rates for Crop Insurance policies; approves new types of Crop Insurance policies; and administers the government budgetary outlays that make the Crop Insurance Program possible. The Companies sell the policies to agricultural producers, and more generally administer delivery of Crop Insurance to agricultural producers.[9]

6. The statuory basis for the program is the *Federal Crop Insurance Act*,[10] as amended in particular by the *Agriculture Risk Protection Act*.[11] In addition to these statutes, the Standard Reinsurance Agreements, which are contracts between the FCIC and the Companies, set forth in detail the terms of the relationship between the FCIC and the Companies.[12]

7. Under the Crop Insurance Program, the United States requires the Companies: (i) to provide insurance at mandatory below-market premiums, set or approved by the Government; and (ii) to make insurance available to any eligible producer in each State in which they offer insurance, irrespective of risk.[13] To enable the Companies to provide these

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Revenue Insurance", available at http://www.ers.usda.gov/publications/agoutlook/may1999/ao261d1.pdf, accessed 15 January 2008.

[8] *See* RMA Fact Sheet, "About the Risk Management Agency", January 2006, available at http://www.rma.usda.gov/pubs/2000/PAN-1667-02.pdf, accessed 8 January 2008; *see also* the National Agricultural Law Center, "The Federal Crop Insurance Program – An Overview", available at www.nationalaglawcenter.org/assets/overviews/cropinsurance.html, accessed 30 January 2008.

[9] Local offices of the USDA, or the FCIC, may offer coverage if this is not available privately. *See FCIA*, Sec. 508(b)(4) and (c)(1).

[10] *Federal Crop Insurance Act* (FCIA) of 1980 (P.L. 96-365).

[11] *Agriculture Risk Protection Act* (ARPA) of 2000 (P.L. 106-224). The *Federal Crop Insurance Reform Act* of 1994 (P.L. 103-354), and the *Federal Agriculture Improvement and Reform Act* 1996 (P.L. 104-127), Subtitle H, had also brought about significant changes. Further provisions governing the operation of Crop Insurance are laid down in the FCIC General Administrative Regulations, 7 CFR Part 400.

[12] 1998 Standard Reinsurance Agreement, for 1998 to 2004, and 2005 Standard Reinsurance Agreement, for 2005 and subsequent years, available at www2.rma.usda.gov/pubs/ra/#05sra. The Standard Reinsurance Agreements apply uniformly to all insurance companies: Vedenov, Miranda, Dismukes and Glauber, "Economic Analysis of the Standard Reinsurance Agreement", in Agricultural Finance Review, Fall 2004, p. 121.

[13] Economic Research Service/USDA, Amber Waves, Volume 3, Issue 3, June 2005, p. 39, available at http://www.ers.usda.gov/Amberwaves/June05/pdf/FeatureCropInsuranceJune05.pdf, accessed 14 January 2008, p. 39.

benefits to the producers, the U.S. Government makes payments to the Companies, comprising four main integrated components.[14] In essence, the U.S. Government pays the Companies for the costs that the Companies cannot recover because of the Government requirement that they make mandatory below-market premiums, and for the risks that the Companies would otherwise not agree to underwrite. The four, integrated components of these government payments are described below.

8. *First*, the Government pays to the Companies a portion of the insurance "**indemnities**" that the Companies owe to the farmers.[15] Under the applicable reinsurance arrangements, the Government reimburses greater portions of the indemnities on the more risky insurance policies,[16] and part of the Government reimbursements also increase as the actual Company losses increase.[17] This is a necessary *quid pro quo* for the requirement that the Companies insure any eligible producer irrespective of the risk, because it reduces the Companies' exposure to that risk.[18] The United States *notified* the "indemnities" component to the WTO as non-product-specific amber box domestic support.

9. *Second*, the Government pays "**underwriting gains**" to the Companies.[19] The risk-sharing arrangements in the Standard Reinsurance Agreement are designed to provide a profit to the Companies, as these would otherwise make no profit because of the mandatory below-market premiums; this profit is labelled "underwriting gains."[20] The Government

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[14] The Government incurs two other outlays for the Crop Insurance Program: RMA administrative and operating expenses and certain R&D reimbursements: *see, e.g.*, the USDA Budget Summaries (the entry for "Administrative and Operating Expenses", and footnote "a" to the entry for "Delivery and Other Administrative Expenses"), and the U.S. Budget (obligations for RMA personnel, equipment, *etc*., and "ARPA costs", or, until 2000, "Research and development expenses"). However, the value of these outlays is relatively low.

[15] 1998 Standard Reinsurance Agreement, pp. 8-14; and 2005 Standard Reinsurance Agreement, pp. 9-14. *See also* FCIA, 508(k); 7 C.F.R. Sec. 400.161 ff.; and Economic Research Service/USDA Agricultural Outlook 1999, "Recent Developments in Crop Yield & Revenue Insurance", available at http://www.ers.usda.gov/publications/agoutlook/may1999/ao261d1.pdf, accessed 15 January 2008, p. 20.

[16] This is the case both under the "proportional" reinsurance arrangements (1998 Standard Reinsurance Agreement, pp. 8-12, and 2005 Standard Reinsurance Agreement, pp. 9-12), and the "non-proportional" reinsurance arrangements (1998 Standard Reinsurance Agreement, pp. 12-14, and 2005 Standard Reinsurance Agreement, pp. 12-14). [Other references]

[17] Under the "non-proportional" reinsurance arrangements: 1998 Standard Reinsurance Agreement, pp. 12-14, and 2005 Standard Reinsurance Agreement, pp. 12-14.

[18] *See, e.g.,* Ron Brichler Testimony before the General Farm Commodities and Risk Management Subcommittee, House Committee on Agriculture, June 7, 2007, available at http://agriculture.house.gov/testimony/110/h70607/Brichler.doc, accessed 14 January 2008, p. 7.

[19] *See* 1998 Standard Reinsurance Agreement, pp. 8-14 (and in particular pp. 9-12 on non-proportional reinsurance), and 2005 Standard Reinsurance Agreement, pp. 12-14 (and in particular pp. 9-12 on non-proportional reinsurance).

[20] This profit is described as "underwriting gains" from the point of view of the Companies: *see, e.g.*, the USDA Budget Summaries for FY 2007 (p. 34), FY 2006 (p. 31), FY 2005 (p. 37), FY 2004 (p. 23), FY 2003 (p. 27), FY 2002 (p. 22), and FY 2001. But from the point of view of the Government, they are described as "underwriting losses": *see* the FCIC/RMA Appendix to the U.S. Budget for FY 2007 (p. 99), FY 2006 (p. 100),

artificially generates this profit, at the cost of greater losses to the Government, by retaining more risk on the worse-performing contracts than on the profitable ones.[21] The payment of underwriting gains is thus a necessary *quid pro quo* for below-market premiums.[22] The United States *did not notify* the "underwriting gains" component to the WTO as part of its domestic support notifications.

10. *Third*, the Government pays "**cost allowances**" to the Companies, to cover their administrative and operating expenses incurred for the delivery of the insurance policies.[23] This is yet another outlay through which the Government secures below-market premiums for agricultural producers. The Government pays for the Companies' administrative and operating costs, because it does not allow the Companies to recover those costs through higher premiums.[24] The United States *did not notify* the "cost allowances" component to the WTO as part of its domestic support notifications.

11. *Fourth*, in addition to lowering the premiums by paying for Company expenses that would otherwise have to be passed on to the producers, the Government pays to the Companies a portion of those already low premiums; this payment is known as the "**premium subsidy**".[25] For example, if through the operation of the first three components of the Program the United States had lowered the premium for a given policy to $100, the

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FY 2005 (p. 102), FY 2004 (p. 91), FY 2003 (p. 101), FY 2002 (p. 99), and FY 2001 (p. 93). *Vice versa,* when there is no such profit, but rather a loss to the Companies, the USDA Budget Summaries speak of an "underwriting loss", and the U.S. Budget of an "underwriting gain"; this happened in marketing year 2002 (fiscal year 2003).

[21] This is the purpose of the existence of different reinsurance funds, and moreover of the non-proportional reinsurance arrangements: *see* the 1998 Standard Reinsurance Agreement, pp. 8-14 and the 2005 Standard Reinsurance Agreement, pp. 9-14. [Other references]

[22] *See* Economic Research Service/USDA, Agricultural Outlook/August 1999, "Crop and Revenue Insurance: Bargain Rates but Still a Hard Sell", p. 16; and Ron Brichler Testimony before the General Farm Commodities and Risk Management Subcommittee, House Committee on Agriculture, June 7, 2007, available at http://agriculture.house.gov/testimony/110/h70607/Brichler.doc, accessed 14 January 2008, p. 10.

[23] FCIA, Sec. 508(k)(4)(A); 1998 Standard Reinsurance Agreement, Sections III(A) and IV, as amended by Amendments No. 1, 2 and 3; 2005 Standard Reinsurance Agreement, pp. 1 and 15-17; and FCIA, Sec. 516(a)(2)(D) and Sec. 522. *See also*, for marketing years 1999 and 2000, FY1999 Omnibus Appropriations Act (P.L. 105-277), and FY2000 agriculture appropriations act (P.L. 106-78), Sec. 814.

[24] *See* Economic Research Service/USDA, Agricultural Outlook/August 1999, "Crop and Revenue Insurance: Bargain Rates but Still a Hard Sell", p. 16.

[25] *FCIA*, Sec. 508(e); 1998 Standard Reinsurance Agreement, p. 16, and 2005 Standard Reinsurance Agreement, p. 15. The Standard Reinsurance Agreement refers to this outlay as the "risk subsidy." Moreover, during crop years 1999 and 2000 the U.S. Government paid an even greater portion of the premium; these sums paid by the Government in addition to the already existing premium subsidy were referred to as "premium discount" (the legal bases for these additional sums were the FY1999 Omnibus Appropriations Act (P.L. 105-277), and FY2000 agriculture appropriations act (P.L. 106-78), Sec. 814; *see* R. M. Chite, "Federal Crop Insurance and the Agriculture Risk Protection Act of 2000 (P.L. 106-224)", 13 November 2000, available at http://digital.library.unt.edu/govdocs/crs//data/2000/upl-meta-crs-1062/RL30739_2000Nov13.html). These sums are included in the figures notified by the United States for crop years 1999 and 2000.

United States would then lower this premium for the producer even further, by paying, say, $67 out of the $100. Therefore, through this fourth program component, like through the other three, the Government reduces the price of insurance for agricultural producers.[26] The United States *notified* the "premium subsidy" component to the WTO as non-product specific amber box domestic support.

12. Data on the outlays for these four program components are available from a number of U.S. Government budgetary documents.[27] Further, because the United States tabulates Crop Insurance on the basis of marketing years, it is possible to tabulate the marketing year data for these government budgetary outlays.[28]

13. The United States identified the Crop Insurance Program in its notifications as the "Crop and revenue insurance subsidized by the Federal Crop Insurance Corporation." The United States categorized this program as non-product-specific amber box support.[29] However, a close review of the U.S. notifications compared to total outlays under the Crop Insurance Program indicates that the United States did not include outlays relating to two of the four integrated components described above – the underwriting gains, and the cost allowances. The value of the two omitted outlays amounted to an average $674 million and $408 million per year, respectively.[30]

14. Set out below are further details relating to the two components of the Crop Insurance Program that the United States has omitted from its notifications, *i.e.* cost allowances and underwriting gains.

Cost Allowances

[26] *See, e.g.,* Economic Research Service/USDA, Agricultural Outlook/August 1999, "Crop and Revenue Insurance: Bargain Rates but Still a Hard Sell", pp. 16-17.
[27] USDA Budget Summaries for FY 2007 (p. 34), FY 2006 (p. 31), FY 2005 (p. 37), FY 2004 (p. 23), FY 2003 (p. 27), FY 2002 (p. 22), and FY 2001; and the FCIC/RMA Appendix to the U.S. Budget for FY 2007 (p. 97 ff.), FY 2006 (p. 100 ff.), FY 2005 (p. 100 ff.), FY 2004 (p. 88 ff.), FY 2003 (p. 99 ff.), FY 2002 (p. 97 ff.), and FY 2001 (p. 91 ff.); and USDA Budget Outlays (Expenditures) from Appropriations, Loan Authorizations, and Corporations and Other Revolving Funds, Fiscal Years 1999 through 2006 and Estimates for 2007 and 2008, RMA; the RMA database, available at http://www3.rma.usda.gov/apps/sob/crop.cfm; and GAO Testimony, "Crop Insurance – Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable," 7 June 2007, available at www.gao.gov/new.items/d07944t.pdf, p. 14. The RMA database provides marketing year data. Data in the GAO report is partly by marketing year and partly by fiscal year. All other source documents provide data by fiscal year.
[28] Table 1, following para. 29, and [reference to detailed crop insurance calculation].
[29] G/AG/N/USA/60, pp. 27, 80 and 106; G/AG/N/USA/51, pp. 38 and 77; G/AG/N/USA/43, p. 36
[30] *See* Table 1 below.

15. The U.S. Government pays cost allowances to the Companies, "on behalf of the policyholder."[31] The policy-holder is the U.S. "domestic producer." The purpose of the cost allowances is, as the name suggests, to cover the administrative and operating expenses incurred by the Companies for delivering insurance policies under the Crop Insurance Program.[32] The amount reimbursed depends on the size of the Companies' net book premium, and the type of insurance policies they have sold.[33]

16. These cost allowances are one of the Program components through which the United States secures below-market premiums for its agricultural producers.[34] The United States administratively sets the premium rates at a lower level than the market would allow, and pays for the costs, and profits, that the Companies cannot recover through the premiums. It pays for those costs, among others, through the cost allowances.[35]

17. Under normal market conditions, the insurance companies would have to set the premium rates to cover the expected indemnities, administrative and operating costs, and secure a profit.[36] Therefore, in such a market-based environment, agricultural producers purchasing insurance would have to pay increased premiums that would take account of administrative and operating costs, and allow for a profit.[37] But the U.S. Crop Insurance Program is not market-based. Under the Program, the U.S. Government pays for the Companies' administrative and operating expenses through the payment of cost

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[31] 1998 Standard Reinsurance Agreement, Definitions, p. 1; and 2005 Standard Reinsurance Agreement, Definitions, p. 1.
[32] FCIA, Sec. 516(a)(2)(B) and (b)(1)(C).
[33] FCIA, Sec. 508(k)(4)(A); 1998 Standard Reinsurance Agreement, pp. 1 and 16-19, as amended by Amendments No. 1, 2 and 3, and 2005 Standard Reinsurance Agreement, pp. 1 and 15-17. The Government pays an "A&O subsidy" for the delivery of policies with additional coverage, and a "Loss Adjustment Expense" for the delivery of the basic "CAT" policies. he Government also reimburses certain research and development expenses incurred by the Companies, under FCIA, Sec. 516(a)(2)(D) and Sec. 522(b).
[34] *See* paras. 7 to 10 above.
[35] Economic Research Service/USDA, Agricultural Outlook/August 1999, "Crop and Revenue Insurance: Bargain Rates but Still a Hard Sell", p. 16; FCIA, Sec. 516(a)(2)(B) and (b)(1)(C) FCIA, Sec. 516(a)(2)(B) and (b)(1)(C); 1998 Standard Reinsurance Agreement, pp. 1 and 16-19, as amended by Amendments No. 1, 2 and 3, and 2005 Standard Reinsurance Agreement, pp. 1 and 15-17.
[36] Economic Research Service/USDA, Agricultural Outlook/August 1999, "Crop and Revenue Insurance: Bargain Rates but Still a Hard Sell", p. 16.
[37] Economic Research Service/USDA, Agricultural Outlook/August 1999, "Crop and Revenue Insurance: Bargain Rates but Still a Hard Sell", p. 16.

allowances,[38] to allow the Companies to sell crop insurance at the below-market rates set by the Government.[39]

18. The Economic Research Service of the USDA confirms these facts. In its analysis of the "bargain rates"[40] of Crop Insurance, the Economic Research Service explains how the Government's reimbursement of the Companies' cost allowances (as well as the transfer of profits to the Companies through the risk-sharing arrangements discussed below) is directly reflected in lower producer premiums:

> ***Under most private insurance policies:***
> Total premiums = expected indemnities + administrative costs + profit margin
>
> What makes government-subsidized insurance such a good deal? Under most private insurance programs—e.g., automobile, homeowners, health—premiums are set to include all expected indemnities (payments made on qualifying losses), plus all the costs of administering the policies, plus a reasonable profit. […]
>
> ***Under FCIC-backed crop insurance:***
> Total premiums = expected indemnities
>
> <u>Under the FCIC-backed crop insurance program, government payments to insurance carriers are used to ensure that total premiums are set to cover expected indemnities only, which reduces the premiums paid by farmers</u>. Federal crop insurance subsidies are designed, in large part, to equate premium rates with the long-term chance of loss.[41] (Underlining added)

[38] 1998 Standard Reinsurance Agreement, pp. 16-19 as amended by Amendments No. 1, 2 and 3; 2005 Standard Reinsurance Agreement, pp. 1 and 15-17.

[39] Economic Research Service/USDA, Agricultural Outlook/August 1999, "Crop and Revenue Insurance: Bargain Rates but Still a Hard Sell", p. 16; Economic Research Service/USDA, Agricultural Outlook, May 1999, "Recent Developments in Crop Yield & Revenue Insurance", available at http://www.ers.usda.gov/publications/agoutlook/may1999/ao261d1.pdf, accessed 15 January 2008, p. 21; Ron Brichler Testimony before the General Farm Commodities and Risk Management Subcommittee, House Committee on Agriculture, June 7, 2007, available at http://agriculture.house.gov/testimony/110/h70607/Brichler.doc, accessed 14 January 2008, pp. 8 and 10; B. Babcock "How to Save Billions in Farm Spending", (2007) 13(4) Iowa Ag Review 4, pp. 5 to 6; R. Dismukes and J. Glauber, "Why Hasn't Crop Insurance Eliminated Disaster Assistance?", Economic Research Service/USDA, Amber Waves, Volume 3, Issue 3, June 2005, p. 39, available at http://www.ers.usda.gov/Amberwaves/June05/pdf/FeatureCropInsuranceJune05.pdf, accessed 14 January 2008, p. 39.

[40] Economic Research Service/USDA, Agricultural Outlook/August 1999, "Crop and Revenue Insurance: Bargain Rates but Still a Hard Sell".

[41] Economic Research Service/USDA, Agricultural Outlook/August 1999, "Crop and Revenue Insurance: Bargain Rates but Still a Hard Sell", p. 16.

19. As the Economic Research Service concludes, U.S. government payments to the Companies "are used to ensure" low premiums for the agricultural producers. The United States itself has notified outlays paid directly to the Companies (the premium subsidy and the indemnities) as support in favour of domestic producers. The apparent object of the payments to the Companies is to enable them to offer crop insurance to U.S. domestic producers at the mandatory low premiums.

20. The Companies acknowledge that *but for* the "cost allowances" they could not agree to sell insurance to agricultural producers at the mandated low premiums. Before the General Farm Commodities and Risk Management Subcommittee of the House Committee on Agriculture, a Vice President of one of the Companies testified that:

> … delivery expenses (administrative and operating expenses (A&O) reimbursements) are paid on behalf of farmers by the federal government and therefore must be incorporated as *a direct transfer of income benefit to farmers*.
>
> […]
>
> Growers are able to purchase crop insurance at more affordable prices *because* the government shares in the risk and administrative premium costs.[42]

Underwriting Gains

21. The underwriting gains are the second Program component that the United States omitted from the notifications. They are one of the results of Government reinsurance under the Crop Insurance Program – the other being the "indemnities" that the United States has notified. These underwriting gains are generated from reinsurance arrangements.

22. Reinsurance has two prongs: proportional and non-proportional. First, under the proportional prong of reinsurance, the Companies cede to the Government part of the premiums on each Crop Insurance policy they sell.[43] If the policyholder incurs a loss covered by the insurance policy, the Government will pay to the Company the

[42] Ron Brichler Testimony before the General Farm Commodities and Risk Management Subcommittee, House Committee on Agriculture, June 7, 2007, available at http://agriculture.house.gov/testimony/110/h70607/Brichler.doc, accessed 14 January 2008, pp. 8 and 10.
[43] For example, 40 per cent of the premium.

corresponding portion of the indemnities.[44] Second, under the non-proportional prong of reinsurance, the Government and the Companies also share the losses, and gains, on the portion of the premiums that was not covered by proportional reinsurance.[45]

23. Under both proportional and non-proportional reinsurance, the Government absorbs greater portions of the program losses on the insurance policies that carry the greatest risk.[46] Moreover, under non-proportional reinsurance, the percentage of the loss that the Companies are required to take on decreases further as the actual loss increases. The percentage of any gain that Companies receive, too, decreases as the gain gets larger; but it does so to a lesser degree than in the case of losses.[47]

24. Through the operation of its two prongs, reinsurance thus generates two Government budgetary outlays: "indemnities" paid to the Companies, and "underwriting gains" paid to the Companies. Together, these outlays contribute to securing the central benefits of the Program for farmers, namely: (i) crop insurance coverage despite the risk this carries; and (ii) below-market crop insurance premiums. Specifically, through the payment of indemnities the Government takes on risk that private Companies would otherwise not insure,[48] and through (among others) the payment of underwriting gains the Government allows the sale of insurance at below-market premiums.[49]

25. Under normal market conditions any premiums would have to cover the expected indemnities, the administrative and operating costs incurred by the Companies, and

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[44] 1998 Standard Reinsurance Agreement, pp. 8-12; and 2005 Standard Reinsurance Agreement, pp. 9-12. In our example, the Government would pay 40 per cent of the indemnities under the proportional prong of reinsurance.

[45] 1998 Standard Reinsurance Agreement, pp. 12-14; and 2005 Standard Reinsurance Agreement, pp. 12-14. In our example, the Government and Companies would share the losses or gains arising on the remaining 60 per cent of the business.

[46] The Standard Reinsurance Agreement provides for the Companies to allocate each insurance policy, once sold, to one of a number of Funds. Each Fund carries different percentages of risk-sharing between the Government and the Companies. The system is designed for the Companies to cede to the Government greater percentages of the risk on the riskier contracts, while retaining greater percentages of the risk on the actuarially sounder contracts. And this is the way the system operates. [*omitted*]

[47] 1998 Standard Reinsurance Agreement, pp. 12-14; and 2005 Standard Reinsurance Agreement, pp. 12-14.

[48] *See e.g.* Ron Brichler Testimony before the General Farm Commodities and Risk Management Subcommittee, House Committee on Agriculture, June 7, 2007, available at http://agriculture.house.gov/testimony/110/h70607/Brichler.doc, accessed 14 January 2008, table at p. 6 and points 4-5 at p. 7.

[49] As discussed in this Sub-section.

a profit.[50] It is worth repeating the two equations used by the USDA Economic Research Service to illustrate the matter:

> ***Under most private insurance policies:***
> Total premiums = expected indemnities + administrative costs + profit margin
>
> […]
>
> ***Under FCIC-backed crop insurance:***
> Total premiums = expected indemnities[51]

26. The U.S. Government reduces the insurance premium by directly paying for the Companies' administrative and operating costs and profit, which under normal market conditions would instead be reflected in the premium rates. The cost allowances paid by the Government are intended to cover the first of these two items.[52] The underwriting gains replace the second item, *i.e.* the profit, as explained below.

27. The Government artificially generates a profit for the Companies through the reinsurance arrangements. Through the unequal distribution of risk between the Government and the Companies, the Standard Reinsurance Agreement are designed so that the Government will transfer profits (underwriting gains) to the Companies even as the Crop Insurance Program is loss-making, at the cost of greater government losses. The reinsurance arrangements have achieved this intended result in all the years except for marketing year 2002; in all these years, despite suffering a net loss from the operation of the Program, the Government also transferred to the Companies net underwriting gains.[53]

28. As a result, premiums do not need to allow for profit in normal market conditions, and the Companies are able and willing to operate at the mandatory below-market premiums.[54]

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[50] *See* paragraphs 16 and 17 above.
[51] Economic Research Service/USDA, Agricultural Outlook/August 1999, "Crop and Revenue Insurance: Bargain Rates but Still a Hard Sell", p. 16.
[52] *See* paras. 14 ff. above.
[53] GAO Testimony, "Crop Insurance – Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable," 7 June 2007, at www.gao.gov/new.items/d07944t.pdf, p. 14. *See also* the data, reported on a fiscal year basis, in the USDA Budget Summaries for FY 2007 (p. 34), FY 2006 (p. 31), FY 2005 (p. 37), FY 2004 (p. 23), FY 2003 (p. 27), FY 2002 (p. 22), and FY 2001; and the data, reported on a fiscal year basis, in the FCIC/RMA Appendix to the U.S. Budget for FY 2007 (p. 99), FY 2006 (p. 100), FY 2005 (p. 102), FY 2004 (p. 91), FY 2003 (p. 101), FY 2002 (p. 99), and FY 2001 (p. 93).
[54] Economic Research Service/USDA, Agricultural Outlook/August 1999, "Crop and Revenue Insurance: Bargain Rates but Still a Hard Sell", p. 16; and Ron Brichler Testimony before the General Farm Commodities and Risk Management Subcommittee, House Committee on Agriculture, June 7, 2007, available at http://agriculture.house.gov/testimony/110/h70607/Brichler.doc, accessed 14 January 2008, pp. 8 and 10.

Calculation of Support under the Crop Insurance Program

29. Table 1 provides the value of the U.S. government budgetary outlays for the Crop Insurance Program for each of the relevant marketing years. To recall, these outlays are calculated as follows: indemnities, underwriting gains (or losses), cost allowances and premium subsidy are totalled. The premiums and fees received by the U.S. Government are then subtracted. This leaves the net total Crop Insurance Program outlays.

Table 1.[55] AMS Value of the Crop Insurance Program

Outlay item \ Marketing year	**1999**	**2000**	**2001**	**2002**	**2004**	**2005**
Indemnities	**2,435**	**2,595**	**2,960**	**4,067**	**3,209**	**2,366**
Underwriting gains (or losses)	**272**	**268**	**346**	**-48**	**692**	**916**
Cost allowances	**501**	**552**	**642**	**626**	**890**	**830**
Premium subsidy	**1,392**	**1,348**	**1,773**	**1,741**	**2,477**	**2,344**
Premiums and fees	**-2,310**	**-2,540**	**-2,962**	**-2,916**	**-4,186**	**-3,949**
Total	2,290	2,223	2,759	3,470	3,082	2,507
Notified	***1,514***	***1,396***	***1,770***	***2,889***	***1,123***	***756***
Difference (Total – Notified)	***776***	***827***	***989***	***581***	***1,959***	***1,751***

All figures in this table are in million $

The contribution of the Crop Insurance Program to the U.S. non-product specific AMS is, therefore: for marketing year 1999, $2,290 million; for marketing year 2000, $2,223 million; for marketing year 2001, $2,759 million; for marketing year 2002, $3,470 million; for marketing year 2004, $3,082 million; and for marketing year 2005, $2,507 million.

[55] [Reference to detailed calculation] Sources: for indemnities, premium subsidy, and premiums and fees, the RMA database of support, by crop year, donwnloaded at http://www3.rma.usda.gov/apps/sob/crop.cfm; for underwriting gains or losses, and cost allowances, GAO Testimony, "Crop Insurance - Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable," 7 June 2007, p. 14; for the notified amounts, US Notifications to the WTO for marketing years 1999 (G/AG/N/USA/43, p. 36), 2000 and 2001 (G/AG/N/USA/51, pp. 38 and 77), 2002, 2004 and 2005 (G/AG/N/USA/60, pp. 27, 80 and 106).