

Further peculiarities of coupled and decoupled payments

The challenge of identifying the ways in which coupled and decoupled payments affect agricultural production is one that must be met if we are to enact farm programs that have any chance of staying within reasonable budget constraint while at the same time providing some level of financial stability for the farm sector. In an earlier column we argued that payments of any sort (coupled or decoupled) have a clear impact on asset values, especially land and probably on who farms the land. In this column we will take our analysis one step further by first looking at how we got to where we are with the 2002 Farm Bill.

Traditionally, farm legislation has required farmers to comply with certain conditions which often included tying (coupling) payments to production decisions. Beginning with the first comprehensive farm legislation, the Agricultural Adjustment Act of 1933, farmers received payments in exchange for entering into contracts to reduce acreages of specific crops or number of pigs.

Over time, we have come to see that farm payments can be coupled to production in several ways. Under some policy prescriptions, the more farmers produced, the more they received in payments. Or, in the case of the acreage reduction programs which were in effect in some years, the larger the cut in acreage, the more the farmer received. Either way payments generally were coupled to conditions that involved production decisions.

Many economists have argued that such payments distort price signals and often result in overproduction which further reduces prices. Likewise, it has been argued that without these coupled payments, farmers would take their planting signals from the marketplace and increase and decrease production with changes in market conditions.

As an alternative to the traditional policy prescriptions, decoupled payments were advanced as a mechanism that could provide income stability for farmers and retain the confidence of their bankers, all without interfering with planting decisions. The direct payments, although based upon historical production, would be the same no matter what an eligible farmer planted. By decoupling the payments in this way, farmers, it was argued by economists and others, would make production decisions based only on market signals. After all, they argued, lump-sum payments do not affect the standard profit maximization calculation prescribed by economic theory.

In 1985, Senator Rudy Boschwitz of Minnesota and Senator David Boren of Oklahoma introduced legisla-

tion that would have provided such decoupled payments to farmers. It was not received well. Farm organizations and commodity groups denounced the plan, calling it welfare for farmers. But when decoupled payments were introduced again in 1996, the largest and most influential farm organizations and commodity groups were somehow won over. The decoupling of payments in the 1996 Farm Bill was a major change in U.S. policy.

In the years since 1996, we have seen that payment decoupling has greatly affected decisions about which crop to grow. As a result, there has been a considerable shift in acres allocated to the various crops with soybeans and corn, the gainers, and wheat, the loser. Planting flexibility, made possible by decoupling payments, has been a real benefit of the 1996 legislation.

After several years under the 1996 Farm Bill, one of the conclusions that most agricultural economists came to is that payments of any kind, coupled or decoupled, have some impact on the income/wealth of producers. Income effects and risk reduction are likely to be the primary ways in which decoupled production flexibility contract payments continue to have an effect, albeit indirect, on agricultural production. One of the consequences of this additional income/wealth is increasing agricultural investment which support tractor sales and keep land prices up. Additional income effect may also increase the rate at which production increasing, and/or cost reducing technologies can be introduced into agriculture.

The bottom line is that most economists once believed that decoupled payments had no effect on production decisions, but now they are having second thoughts. Clearly, doing away with coupled payments and instituting planting flexibility allows for changes in the mix of crops. What is less clear, is how decoupled payments affects total crop acreage. Some economists suggest that payments, whether coupled or decoupled, affect total crop acreage by relatively little. Even if total acreage affects are small, decoupled (and coupled) payments do effect resource valuation, especially, the price and lease rates for land, and the rate at which farm consolidation takes place.

Daryll E. Ray holds the Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee, and is the Director of the UT's Agricultural Policy Analysis Center. (865) 974-7407; Fax: (865) 974-7298; dray@utk.edu; <http://agpolicy.org>.