

Decoupled Payments: Are the Effects Explained by Calculus or Simple Arithmetic?

Some agricultural economists prefer the 1996 Farm Bill to traditional farm legislation. One of the things they especially like about it is decoupled payments. If payments must be made, those economists reason, then the payments should be decoupled—that is they should not be tied to production decisions.

These agricultural economists like decoupled payments because, theoretically, acreage-use decisions are made independently of the fixed payments. And, of course, the contract payments of the 1996 Farm Bill are fixed. Farmers receive the same contract payment no matter which crops they plant.

While decoupled payments sound like just another name for planting flexibility, it's more inclusive than that. From the perspective of many economists, decoupled payments is planting flexibility on steroids. It not only includes the idea of farmers planting whatever they want, but, just as importantly, it explicitly includes not planting anything at all.

Thus, with decoupled payments, economists expect the total acreage of major crops to fall in response to a decline in the prices of all major crops, in addition to observing changes in the crop mix if the prices of some crops change more than others. Hence, supply of the major crops should be more responsive to changes in general price levels when payments are decoupled.

For several decades, in fact, many economists maintained that the “coupled” payments and price supports of past programs were a major cause of the farm problem because these coupled programs artificially held too many resources in agriculture, depressing prices. Do away with coupled payments, they would argue, and prices will rise as fewer acres and other resources would be used in agriculture. But, as we have seen in a previous column and in the August 11 issue of the USDA's World Agriculture Supply and Demand Estimates, total acreages for major crops have not declined—even with the decoupled contract payments of current legislation and a near 40 percent drop in season average crop prices.

The theory is clear. When these economists apply their graduate-school-learned calculus approach to evaluate farmers' efforts to maximize their profits, any lump-sum direct payment literally falls out of the decision-mak-

ing equation. Accordingly, it makes no difference whether farmers receives lump-sum payments of one dollar, one hundred dollars, one hundred thousand dollars or no payment at all, their production decisions—based on prices—is the same; and, if variable costs aren't covered, they will not plant at all.

The question is: does the theory match reality? Does the theoretical result of a “no production effect” from decoupled payments accurately predict how farmers use information on anticipated fixed payments when they make acreage/production decisions? Do farmers ignore the knowledge that they will be receiving contract payments when making production decisions? Or, do they mentally convert the payment to cents per bushel or pound, add the result to the expected price or loan rate and use that sum to make production decisions? The payment also could have a “wealth effect” which loosens farmers' capital constraints, convincing bankers to lend required operating money or in other ways provides staying power for the farmer.

So, are decoupled payments a “calculus issue” in which the lump-sum payments fall out of consideration or are they part of an arithmetic problem in which farmers consciously combine fixed payments, measured per bushel, with expected price when deciding what to grow? Based on what I have seen written, farmer advisory services and other sources of outlook advice explicitly use the arithmetic approach—as do most of the farmers I have talked with. Actually, the arithmetic view of payments is most often volunteered in discussions with farmers.

Economists can protest farmers' arithmetical inclusion of decoupled payments in the decision-making process as not consistent with theory if they want to. But, that seems counterproductive if the theory does not predict farmer behavior.

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