

PolicyPennings by Dr. Daryll E. Ray

# Decoupled payments: Australians ask, decoupled from what?

When the 1996 Farm Bill was approved, the use of decoupled payments was trumpeted as a major achievement. The argument was that these payments were decoupled from production and would make farmers more responsive to market demand conditions and reduce over production. After all, if farmers received a payment whether or not they planted, they would reduce planted acreage when prices were low. It didn't happen and we ended up with massive emergency payments for four years (1998-2001).

Now it turns out that decoupled payments are not fully decoupled after all. That is one of the conclusions of a report released by ABARE (Australian Bureau of Agricultural and Resource Economics). The report titled "The European Union's Common Agricultural Policy: A Stocktake of Reforms" was written by Ivan Roberts and Caroline Gunning-Trant and released this month (August 2007). It is available on the internet at [http://www.abareconomics.com/publications\\_html/crops/crops\\_07/EU\\_cap07.pdf](http://www.abareconomics.com/publications_html/crops/crops_07/EU_cap07.pdf).

The report listed six major ways in which decoupled payments are not fully decoupled from production decisions and some of these apply to the US as well at the EU (European Union):

- In the EU the receipt of some payments are dependent upon having some land currently in production;
- "Income and wealth effects from the payments affect credit availability and adoption of technology, thereby affecting production;"
- Payments are made within a system that provides support in coupled form like tariffs and tariff quotas;
- "Producers' expectations that payment bases and/or rates can be changed by current planting or production decisions and that political pressure can affect current production decisions;"
- "Ongoing payments enable producers to continue to produce products" they are most comfortable with and are currently producing. With payments farmers do not have to consider switching to other production systems they are unfamiliar with; and
- "The payments support agricultural land prices. The higher prices help maintain land in agriculture rather than have it transfer to nonagricultural uses."

We have long asserted that decoupled payments are not decoupled from production for many of the same reasons ABARE noted. At the same time, it seems to us that the "decoupled payment" system has become decoupled from the original reasons why we had farm policies in the first place.

While it is not part of their subsequent analysis, the authors of the report gets at the nub of the matter when they assert "**that with proper decoupling, both producers' and consumers' decisions are supposed to respond to actual prices determined on world markets**" (emphasis added). That would mean that as prices go up consumers should consume less and vice versa when prices decline. Likewise, in the face of lower prices, farmers would produce less, reducing available production and driving prices upward.

This doesn't happen. With regard to aggregate agricultural products, neither consumers nor producers sufficiently respond to changes in prices to balance out supply and demand in a timely fashion. The economic term for this is "low price elasticity" of both supply and demand.

This low price elasticity is a characteristic of aggregate agricultural markets whether payments are coupled, decoupled, or totally absent. It was characteristic of agricultural markets a century and a half ago, some 70 years ago when US farm programs began, and today.

Parenthetically we should note that, as we have seen this year, farmers do respond to high prices by increasing production, but we need to remember that to the extent that these prices bring additional land into crop production, it may take a decade or two to return that land to its former use if prices fall. In addition, we must not confuse switching from one crop to another with the elasticity of aggregate agricultural production. Nearly all of this year's additional US corn acres came from soybeans, cotton and other crops.

While the current programs may be less than ideal, the challenge of agricultural policy is not to find a means of perfectly decoupling payments, but to design policies that take into account the low price elasticity of both supply and demand.

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