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How Do Decoupled Payments Affect Resource Allocations Within the Farm Sector?

When they were initiated in the 1930s, farm subsidy programs were designed to insulate producers from fluctuations in market prices and raise farm household incomes. Under such a system, however, producers base their planting decisions for the subsidized commodities not only on expected market prices and production costs, but also on government payments. To reduce the market distortions associated with government subsidies, efforts to decouple farm income support from planting decisions began in the 1980s, but the most sweeping changes were introduced in farm legislation in 1996 and 2002. Rather than basing payments on current market prices or production levels, production flexibility contract (PFC) payments created in 1996 provide lump-sum payments on eligible acres, with payments based on historical plantings of program crops and yields. As a result, these "decoupled" payments change the income and wealth of a household without distorting relative commodity prices.

In theory, decoupled payments should not influence planting decisions. Nonetheless, questions about the payments' impact on the farm business and farm household well-being remain. ERS researchers used a household framework and household-level data to analyze these issues. They found that:

- In 1992, a producer who rented cropland for cash paid a 21-cent premium per dollar of government payments received, while the same producer paid a 33-cent premium in 1997, 1 year after the PFC program went into effect. Thus, while decoupled payments had a stronger influence on land rental rates than did coupled payments, renters still retained two-thirds of the amount of government payments they received, increasing their income from farming.
- Analysis of farm household labor allocations before and after the introduction of decoupled payments found that both coupled and decoupled payments increased the hours worked on the farm and decreased the hours worked off the farm. Thus, the introduction of decoupled payments had no significant impact on time spent working on the farm.
- Decoupled payments provide farm households with increased purchasing power, which might be used to increase savings and investment. Farm households with limited access to credit might use their decoupled payments to increase onfarm investment. But this is only likely to occur during economic recessions, when credit is constrained.

While the analyses of land, labor, and capital markets suggest that decoupled payments have the potential to indirectly influence farmers' decisions about resource allocation and productivity, the empirical results are mixed and the evidence of significant impacts is ambiguous. Decoupled payments are less distorting than coupled payments, but further study is warranted. AW

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This finding is drawn from . . .

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