

Agnieszka Poczta-Wajda

The Poznań University of Economics, Poland

**DECOUPLED PAYMENTS IN THE AGRICULTURAL POLICY
OF WELL-DEVELOPED COUNTRIES**

*PLATNOŚCI DECOUPLED W POLITYCE ROLNEJ KRAJÓW WYSOKO
ROZWINIĘTYCH*

Key words: decoupling, CAP, direct support

Słowa kluczowe: decoupling, WPR, wsparcie bezpośrednie

Abstract. The aim of this paper is to consider the role of decoupled payments in the agricultural policy of well-developed countries on the example of the EU and the US. Firstly, the idea and history of decoupling in the EU and the US is presented. Further, one attempts to answer some questions about social and economic legitimacy of decoupled payments and tries to formulate recommendations for the future of decoupled direct payments in the CAP.

Introduction

The Common Agricultural Policy (CAP) of the European Union (EU) in the last twenty years has undergone several important reforms aimed at eliminating problems which have emerged since it was established. These reforms set up some new adverse phenomena which called the validity of the CAP into question, both outside and inside the EU. In the conditions of growing economics welfare and the sense of food security it becomes more and more difficult to justify the need of agricultural support and to continue its social legitimacy. The CAP of the EU is strongly criticized also on the international arena, especially within the World Trade Organization (WTO) negotiations. That is why there still exists a need to improve agricultural policy of the EU in order to eliminate its adverse effects. The latest CAP reform from 2003 and the CAP review "Health Check" from 2008 were an important step in this direction. One of the most significant solutions introduced during these reforms was change in direct support mechanism and partially separation of direct payments from the current level and kind of production (so called decoupling). The "Health Check" deepened the range of decoupled payments, but its role was deeper. In fact, it was supposed to prepare us for the next crucial CAP reform after 2013 which will include full decoupling as one of the most important topics. Total separation of payments and the level of production seems to be reasonable from the economic theory point of view and is required to reach the transparency and justice of support system, as well as it will be welcomed by the EU trade partners [Bryła 2008]. Nevertheless, there are some economists and also some countries within the EU, who dispute further decoupling and claim that there should be even stronger dependency between payments and the level and kind of production.

The main aim of this paper is to consider the future of decoupled payments in the system of agricultural support in the EU. Firstly, the idea and history of decoupling is presented. Importance of decoupled payments is analyzed by changes in structure and dynamics of agricultural support with the use of Producer Support Estimate (PSE) and its components. Finally, there is a discussion about the advantages and disadvantages of decoupling, which leads to some recommendations for the future of direct payments.

The idea of decoupling

Traditional measures of agricultural support, related to the current level of output, input and price, widely used in developed countries, cause some undesirable effects on the agricultural markets. First of all, they are the reason of sizeable food surpluses on these markets. Besides, since developed countries are economically strong, as they hold a relevant share of international trade flows with agricultural products, measures of agricultural policy in this countries lead to price

decline on world markets and reduce export possibilities of developing countries. Due to the fact, that part of the market support goes to unintended beneficiaries and it does not eliminate the problem of income inequality, this policy is also very expensive. Figure 1 presents the consequences of the support measures related to the price on the example of government purchase. In the condition of free market mechanism, price would reach P_1 equilibrium level. In order to rise the price, government buys a product on the market. Additional demand from the government (DG) increases the equilibrium price to P_2 . As a consequence, government spending rises not only because it must purchase additional product from the market (dotted area) but also because it must pay for the storage and disposal. Total effects of government purchase are: overproduction, higher consumer price and additional costs for government. The new problem is now how to dispose extra supply. If there exists no possibility to sell the product on the domestic market, a country will try to export it. In case of a well-developed country this might have essential consequences for the world agricultural markets and international relations.

In order to reduce negative effects of market price support, government may introduce direct payments, which mechanism is presented by figure 2. The idea of this measure is that government pays directly to the farmer the difference between lower consumer price P_2 and price P_3 desired by farmers. As a result, consumers can buy more and cheaper than the equilibrium price P_1 , and farmers can sell more but they will get higher income than at the equilibrium price. The problem with the unlimited direct payments is that the more farmer sells, the more payment he will get, which of course encourage him to produce more and results with overproduction.

One of the reasonable solutions to solve that problem seems to be an implementation of decoupled payments, which are not directly tied to the current level and kind of production. This measure supports the farmer in a way it does not distort prices, production, consumption and trade flows. The idea is to base a direct payment on the historical area or level of production. If a farmer gets a payment not related to the current production, he may freely decide what and how much to produce. As expected, he will respond to the market signal and choose production which seems to be the most profitable. Therefore decoupled payments improve market orientation of producers, reduce distortions in supply and trade, rise competitiveness of the sector and improve effectiveness of support. There are many different definitions of decoupling. In a narrow definition decoupled payments do not change decisions of producers and consumers in any way. It means that demand and supply curves remain unchanged after implementation of such payments. In a wide definition, amount of supply and trade remains at the same level, however the demand and supply curves might evolve.

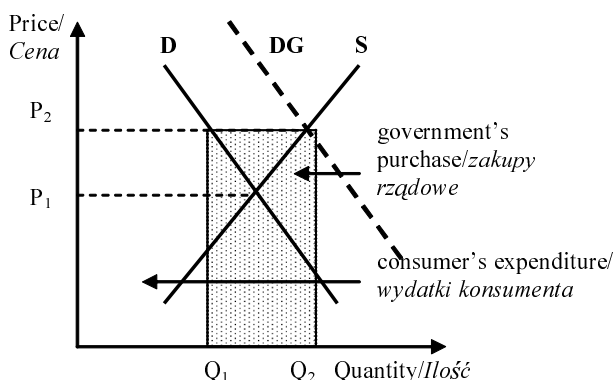


Figure 1. Economic consequences of government purchase measure

Rysunek 1. Ekonomiczne skutki zakupów rządowych

Source: own study based on Tomek, Robinson 2001

Źródło: opracowanie własne na podstawie Tomek, Robinson 2001

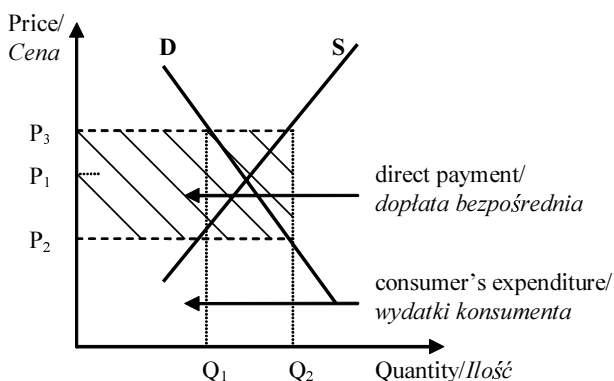


Figure 2. Economic consequences of direct payments

Rysunek 2. Ekonomiczne skutki dopłat bezpośrednich

Source: see fig. 1

Źródło: jak na rys. 1

The influence of decoupled payments on the agricultural production is widely discussed. Some economists represent the view, that there will always be some connection between decoupled payments and farmers' decisions, because they rise land prices, change risk of production, reduce farmer's risk aversion, influence investment's decisions, change expectations towards the future support policy, discourage farmers from leaving the sector etc. [Goodwin, Mishra 2006, Chau, de Gorter 2000, Roe et al. 2002, Sumner 2005]. It is an important question, if one can speak about the decoupled payment, which would not influence farmers' decisions at all, that is which would fulfill the narrow definition of decoupled payment. It seems to be more reasonable to talk about the scale of decoupling instead of measures not related to the agricultural production at all.

Experiences with decoupling in the European Union and the United States

The first serious attempt to implement decoupled payments was noticed in 1949 in the US in the so-called Brannan's Plan. The idea was that a farmer, whose income falls down below a certain level, gets an extra payment. However this solution was rejected by the US Congress. Afterwards, in the Farm Bill of 1985 deficiency payments were introduced. They were based not on the current yield but on the historical one. Decoupling in wider scope was implemented for the first time in 1996 as a crucial element of the next agricultural reform (so-called FAIR Act – Federal Agriculture Improvement and Reform Act). It was aimed at changing agricultural policy in the US due to the requirements of Uruguay Round Agreement on Agriculture. Traditional measures of agricultural policy related to current production were reduced and market price support and deficiency payments were partly replaced by the system of direct payments based on historical area. Payments were paid to the 85% of eligible area, thus the amount of payment was not related to the current production. The FAIR Act 1996, however, introduced also Market Loss Assistance (MLA) payments, which were available in situation when market prices fell below the intervention price. MLA payments were supplementary to the direct payments, had an ad hoc character and as a result many doubted if the direct payments program fulfilled the assumption of truly decoupled system.

The next US agricultural act Farm Bill was introduced in 2002. This act was a bit of surprise for many economists, because instead of declared on the global arena reduction of support, it increased budgetary expenses for agriculture. Although many programs of Farm Bill 1996 were continued (especially direct payments), new forms of support related to current production and prices were introduced. In case of direct payments, farmers were allowed to update reference area or yield, which stands in contradiction to the idea of decoupled payments. The new reference yield was an average yield from years 1998-2001, which means that payments in 2002 were directly related to the production from previous year. The next Farm Bill 2008 preserved the system of direct payments, however it adjusted their level and introduced limits per single farm. New kind of crop payments, which do not have decoupled character, were also introduced and more emphasis was put on national and international food aid.

Influence of Farm Bill 1996, 2002 and 2008 on the structure of budgetary expenses for agricultural sector in the US is presented in Table 1. Support for agricultural producers (measured with Producer Support Estimate – PSE) can be divided into two kinds: market price support (result of intervention prices and trade barriers) and budgetary support. Payments based on input use, payments based on current area or animal number, when production is required and payments based on non-current area or animal number, when production is required can be classified as a coupled support. Whereas payments based on non-current area or animal number, when production is not required have typically decoupled character. It can be noticed that FAIR Act of 1996 changed the structure of budgetary support into more decoupled, which resulted in the sudden growth of payments based on non-current area or animal number, when production is not required (6,6 billions of USD average in 1996-1998). Increase of MLA use in 1998 and following changes in agricultural policy introduced in Farm Bill 2002 and Farm Bill 2008 caused, however, that current agricultural support in the US is less decoupled as it used to be in 1996.

In the European Communities it had also been noticed that agricultural payments related to current production had many adverse effects. In 1986, Mansholt proposed introduction of first measures, which can be called decoupled. The idea was to grant special rents for older farmers in order to encourage them to retire. This plan, however, was not implemented. An important step into direction of more decoupled payment system was made in 1992 during so-called MacSharry's Reform. Intervention prices had been replaced by the compensatory payments. Still, it was not a full decoupling, because in order to get a payment, farmers had to cultivate crops on the eligible area. The amount of payment was related to the kind of production. Furthermore payments in the

Table 1. Structure of agricultural support in the US in the years 1986-2009 (yearly-average)
Tabela 1. Struktura wsparcia dla rolnictwa w USA w latach 1986-2009 (średniorocznie)

Value of production/ Wartość produkcji	Structure of support [mln USD]/Struktura wsparcia [mln USD]							
	1986-1988	1989-1992	1993-1995	1996-1998	1999-2001	2002-2004	2005-2007	2008-2009
	143 469	166 757	184 239	199 990	190 329	213 756	264 040	301 309
PSE in it:/w tym:	36 219	33 545	27 767	35 301	53 021	39 893	34 798	28 821
a	15 996	17 011	13 369	17 954	28 784	16 094	11 848	3 786
b	7 061	7 436	6 732	6 551	7 345	8 339	9 214	9 246
c	12 231	7 575	5 916	2 182	4 895	5 284	3 251	6 295
d	0	0	0	0	0	0	0	0
e	338	0	0	6 647	10 069	7 905	8 096	7 032
f	592	1 524	1 750	1 967	1 927	2 272	2 389	2 461
g	0	0	0	0	0	0	0	0

a – market price support, b – payments based on input use, c – payments based on current area or animal number, production required, d – payments based on non-current area or animal number, production required, e – payments based on non-current area or animal number, production not required, f – payments based on non-commodity criteria, g – miscellaneous payments/a – wsparcie cenowe, b – płatności do nakładów, c – płatności do bieżącej wielkości arealu lub liczby zwierząt, produkcja wymagana, d – płatności do historycznej wielkości arealu lub liczby zwierząt, produkcja wymagana, e – płatności do nieprodukcyjnych, g – pozostałe płatności

Source: own study based on Producer and Consumer... 2010

Źródło: opracowanie na podstawie Producer and Consumer... 2010

EU were based on an aggregate fixed area, which was set at the national or regional level. Individual farmers did not have a base area. They were just owners of eligible hectares, for which they received payments. If the regional base area was exceeded, the subsidy per hectare was adjusted proportionately for all farmers in the region. Because the reduction in payment occurred ex post, farmers had a strong incentive to overplant to maximize their share of fixed budget outlays or to defend against overplanting by other farmers. This proves that the area payments were coupled to planting because individual farmers were not punished for the decision to overplant [Baffes, de Gorter 2005].

Despite the fact that implementation of direct payments in MacSharry's Reform was definitely a step forward, the size of food production in the EU was still much higher than it would have been without any support. The first "true" decoupling was introduced during 2003 Reform in Luxembourg. The new system of direct payments was called Single Payment Scheme (SPS). Payments in the SPS were generally independent from the current production, unless there was a risk of abandonment of agricultural activity in some specific regions. This gave farmers a free hand to decide about the land use, as long as it would be an agricultural use. New Member States implemented simplified system (SAPS). In this system, a payment which receives a farmer consists of single area payment, which is decoupled and complementary national direct payment, which is related to the production. Implementation of a new direct payments system, in which amount of payment is not related to the size and structure of production ensures the EU the possibility to continue the agricultural support at the same level and not to break WTO rules [Buckwell 2008].

In the last CAP review called „Health Check” the dimension of decoupling has been expanded. Specific payments are now available only for suckler cows, sheep and goats. Impact of the above described reforms on the structure of budgetary support in the EU has been presented in Table 2. It can be clearly seen, that the level of support after 1992 reform remained more or less the same. The structure of this support, however, changed significantly.

Market price support declined in favour of payments based on current area or animal number, when production was required. Reform of 2003, in turn, caused significant increase in value of payments based on non-current area or animal number, when production is not required, which represents decoupled SPS payments. It can be noticed, that CAP of the EU evidently evolved from the support being transferred mainly through the market, to the partially decoupled support (MacSharry's direct payments) and finally to the totally decoupled SPS payments.

Table 2. Structure of agricultural support in the EU in the years 1986-2009 (yearly-average)
Tabela 2. Struktura wsparcia dla rolnictwa w UE w latach 1986-2009 (średniorocznie)

Value of production/ Wartość produkcji	Structure of support [mln USD]/Struktura wsparcia [mln USD]							
	1986-1988	1989-1992	1993-1995	1996-1998	1999-2001	2002-2004	2005-2007	2008-2009
	211 380	232 747	220 578	240 653	242 471	255 254	292 581	325 789
PSE in it:/w tym:	88 005	84 460	90 757	94 639	96 488	102 050	97 478	89 888
a	79 853	71 773	59 399	58 103	57 059	56 023	39 787	24 309
b	4 565	5 393	5 717	6 745	7 054	8 654	11 165	12 577
c	3 195	5 762	23 569	29 802	31 872	35 967	18 786	16 471
d	0	0	0	0	0	5	169	179
e	0	318	597	22	16	489	26 205	34 028
f	428	858	1 177	817	1 049	1 163	1 665	2 347
g	-35	356	298	-850	-561	-250	-300	-25

Explanations: see tab. 1/Objaśnienia: jak w tab. 1

Source: see tab. 1

Źródło: jak w tab. 1

Future of decoupling in the system of financial support of CAP

As presented above, decoupling was implemented in the EU in 2003. Member States, however, were allowed to couple part of payments and most of the “old” EU countries used this possibility. One can observe that generally in the EU there is an eagerness to fully decouple all direct payments and “Health Check” proves it. A few counties, however, are against further decoupling and even demand the comeback of more production related payments. During the works on the new CAP reform, future of direct payments and the range of decoupling will play an important role. The main questions which had to be answered are as follows [Bryła 2008]:

- Is the idea of decoupling compatible with the aim of keeping agricultural activity on the whole area of the EU? Is not there a threat that the farmers may resign from production, especially in the mountain areas?
- Is the decline of food production in the EU a desired effect of decoupling in the light of latest food shortage in many parts of the world and significant price rise?
- Is it socially welcome, that farmers may change the logic of thinking from producers to a pensioners, who will not concentrate on farming but on receiving payments and competing for more rights?

On the one hand, supporters of decoupling demand total independency between payments and production and underline positive impact of such policy on European agriculture and its competitiveness on the international arena. Decoupling discredited set-aside duty and reduced the costs of administration. Breach with the obligation of keeping animals or producing crops in order to get a payment, enabled structural changes in the food production, especially in the “new” Member States. Full decoupling provides the possibility to fulfill WTO agreements and to keep similar level of support at the same time.

On the other hand, decoupled payments are not free from drawbacks. These payments are usually related to the possessing of land and therefore they may increase land price. Moreover payments are transferred to people who are land owners but not necessarily farmers. What is more, decoupled payments were implemented to solve problems caused by past policy, so they are based on old assumptions. They preserve existing inequalities between markets, countries and farms. What is then the social and economical justification for this kind of support? Are decoupled payments harmonious with contemporary aims of CAP: competitiveness, social balance, environment, biodiversity, culture heritage, rural area development, food and energy safety? Direct payments, even decoupled ones, do not fulfill these assumptions because they result from past policy and past problems. In a situation, when governmental support is required, it should have clear aims and specified beneficiaries. From the social point of view, every help from government should stimulate changes instead of preventing them. Decoupled payments preserve old state.

Nevertheless, the range of decoupling and future of direct payments are going to be hot topics during incoming talks on next CAP reform. It will be conducted in the conditions of high food prices, expected depreciation of US dollar, high volatility of oil prices and economic crisis. Preserving the environment and landscape may not be any more a sufficient justification for continuing agricultural support. Maybe it is time to put the emphasis again on food security? Maybe the new agricultural policy of the EU should be called Common Food and Environmental Policy?

Conclusions

1. Although the level of agricultural support in well-developed countries remains more or less the same, one can notice some essential changes in its structure. Measures of border protection and price support are being replaced by direct support which becomes more and more decoupled.
2. The idea of decoupling seems to be reasonable from the point of view of international food markets, especially developing countries. It limits distortions in trade and production caused by the agricultural policy of developed countries and reduces food price decline observed on the world markets. There exists, however, the question about the social legitimacy of decoupling.
3. More and more often it is being indicated that decoupling do not accomplish aims of CAP, because it is not orientated to solve given problems, but just preserve dilemmas of the past. Role of decoupling in a new agricultural policy of the EU seems to be unsure.

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Streszczenie

Celem artykułu było określenie znaczenia płatności typu *decoupled* w polityce rolnej krajów wysoko rozwiniętych na przykładzie UE i USA. Omówiono ideę i historię *decouplingu* w UE i USA. W kolejnej części podjęto próbę rozważań na temat społecznej i ekonomicznej zasadności płatności *decoupled* i ich przyszłości w systemie płatności bezpośrednich w ramach WPR.

Corresponding address:

Dr Agnieszka Poczta-Wajda
The Poznań University of Economics
Department of Macro and Agricultural Economics
Niepodległości Avenue 10
61-875 Poznań, Poland
tel. +48 61 854 30 21
e-mail: agnieszka.poczta@ue.poznan.pl