Introduction

Domestic agricultural subsidies were brought under the discipline of global trade rules for the first time in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), which concluded in 1993. In order to reduce the spillover of domestic support onto world markets, GATT members agreed to limit expenditures on domestic agricultural subsidies, with some important exemptions (table 1). One is decoupled income support to producers. This support is defined in the Uruguay Round Agreement on Agriculture (URAA) as payments that are financed by the government (taxpayers) rather than by consumers, are not related to current production, factor use, or prices, and for which eligibility criteria are defined by a fixed, historical base period. (See box on URAA criteria for exemption of domestic support from expenditure limits.) The exemption of decoupled payments provides members of the World Trade Organization (WTO)—the successor organization to the GATT—with the flexibility to transfer income to their agricultural producers, but in a manner presumed to have minimal potential to distort production and trade.

Global agricultural trade negotiations resumed in March 2000 in Geneva. They have since been subsumed into the full round of trade negotiations launched in Qatar in November 2001 by the WTO. The new round, called the Doha Development Agenda, will continue the global agricultural policy reform process begun in the Uruguay Round. The negotiations are expected to address further constraints on domestic support and may include discussion of the criteria under which lump-sum payments can lead to production impacts. This outcome depends on certain assumptions about farmer tolerance for risk, farmer expectations about future payments, and the efficiency of factor—land, labor, and capital—markets (e.g., Tielu and Roberts; European Commission; OECD). Some countries argue that these market conditions exist and lump-sum payments therefore increase aggregate production. Consequently, they argue for lump-sum payments to face similar expenditure limits as traditional, distorting, commodity-based farm subsidies.

This report examines the U.S. experience with decoupled payments in its PFC program during 1996-2002 from the perspective of trade policy. It asks whether the decoupled payments have distorted U.S. agricultural production and therefore trade. Using data on farm households that participated in the PFC program, we analyze the effects of decoupled payments by looking at how the payments increased the income and wealth of participants and change farm household consumption, saving, investment, and work. These decisions can result in changes in the supply of resources to agriculture and in aggregate agricultural production.

Decoupled Payments: Household Income Transfers in Contemporary U.S. Agriculture
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The Uruguay Round Agreement on Agriculture specifies criteria that green-box domestic support must meet in order to be exempted from expenditure limits. These criteria address program design and implementation. Many types of domestic support are exempted in addition to decoupled payments, including extension services, pest and disease control, stock holding for domestic food security, domestic food aid, disaster relief, and environmental programs. All exempted domestic support must meet the same general criteria:

- Support must be provided through a publicly funded government program.
- The support may not have the effect of providing price support to producers.

Different specific criteria exist for each type of program exempted from domestic support limits, reflecting their broadly differing objectives. For example, environmental payments must require specific production methods or use of inputs related to well-defined environmental goals and may only compensate for additional costs of compliance, in addition to meeting the general criteria for exemption. For decoupled income support to be exempt, the following specific criteria must be met:

- Eligibility must be defined by some clearly defined criteria in a fixed base period.
- The amount of the payment must not be related to the type or volume of production, prices, or factor employment in any year after the base period.
- No production shall be required in order to receive the payment.

Source: Uruguay Round Agreement on Agriculture, Annex 2, WTO.