Will Lower Loan Rates Boost Exports?

How can lower loan rates help U.S. agriculture compete for export markets if our competitors continue to subsidize their own producers?

The answer, say many economists, is that lower loan rates will help discourage these subsidies, according to a recent issue of the Agriculture Department's *FARMLINE* magazine.

To follow this line of reasoning, you have to recognize that U.S. loan rates have an impact far beyond the domestic market. U.S. loan rates set a price floor that can reduce the subsidy burden on many foreign competitors, allowing them to undercut our prices at a relatively low cost — a cost they can afford. In recent years, the price floor provided by our loan rates has been high enough to give even many of the less efficient agricultural producers abroad an incentive to increase production.

The U.S. government was, in effect, accepting part of the cost of these foreign subsidies, says economist Keith Collins of USDA's Economic Research Service. Foreign governments could subsidize with the assurance that their budget exposure would be limited by U.S. actions. The U.S. government would step into the market, buying up its farmers' surpluses whenever prices fell to loan rates.

The more that foreign production cut into U.S. sales, the greater the surpluses accumulated by the United States. This policy partly shielded foreign producers from the price consequences of their own rising output.

No More Guarantee

So what happens if we continue to lower the "guaranteed" price floor, allowing our prices to adjust to market demand? To the extent that foreign producers have higher costs of production and are less efficient than our farmers, and that is often the case, we can make these subsidies very expensive to our competitors, Collins says.

To maintain the production incentive, foreign subsidies must rise as world market prices fall. Once it becomes evident that the United States won't price itself out of the market, or buy up the world's surpluses to support prices, other producing nations will recognize that they'll have to share the consequences of larger production.

The assumption is that many of these subsidies will become so expensive, so unaffordable, that the United States is likely to face less competition for markets in the long.

This is one of the assumptions implicit in the 1985 farm bill. Although its validity can only be tested with time, there has already been at least one positive response, says Collins. "Canada recently announced substantial reductions from 1985 in the initial prices it will pay its farmers for 1986 wheat and barley. The Canadians could have chosen to keep prices up but did not."

Another promising sign: recent declines in the value of the U.S. dollar on international currency markets. These declines make it all the more likely that the new price support policies will succeed in stimulating sales of many American commodities. The lower valued dollar makes our exports more competitive and less expensive for foreign buyers whose currencies have appreciated against the dollar. Similarly, it lowers the farm prices facing producers in those competing countries whose currencies have appreciated.

Potential Drawbacks

But there are potential risks to a more aggressive U.S. export policy, especially in the short term, adds Collins. Nations may be tempted to respond by retreating into protectionism or by threatening trade wars. There are also costs to American agriculture in maintaining a competitive edge in a more open world market, costs in terms of resource adjustments, risks of wider price swings, and so on.

In addition, Collins points to the potential for mixed signals that may come from U.S. acreage reduction programs. These programs, he says, have represented an American commitment to eliminate surpluses and raise prices by restricting U.S. production. The future possibility of higher prices and the promise that the United States won't unleash its full production capacity whenever surpluses start rising may weaken efforts to induce our competitors to curtail their own excess production capacity.

The willingness of the United States to continue to pay for acreage reduction programs and for the maintenance of any surplus stocks may bring the issue of foreign subsidies down to the question of "who's got the deepest pockets," says Collins.

Finally, there is uncertainty related to the reaction of importing nations. As a group, these nations have shown considerable growth in self-sufficiency over the last decade. One motive was to protect themselves from sharp, periodic price stability to the market. Lower loan rates mean a "greater opportunity for price instability," Collins explains. This may encourage some importing nations to continue their efforts to reduce dependence on world markets.

"We don't know the final outcome of our new, market-oriented farm policies, and I don't expect to see most of our export competitors actually cutting back on production," says Collins. "What I do expect, however, is a slower rate of expansion in foreign production by both importers and major exporters."

In his view the more competitive stance puts the United States in a position to take advantage of renewed growth in world demand, when it comes. "In essence, our ability to expand production greatly, at low cost, sets us up to be the major beneficiary of future increases in global trade," he contends.