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The Farmers Home Administration

How useful are export promotion programs?

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Over the years the U.S. Government has established a number of agencies to facilitate exports. Some of these agencies and their programs, and their place in a rapidly changing world, are discussed herein.

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The Farmers Home Administration

The Farmers Home Administration capped its fortieth anniversary as a federal credit agency by extending a record $5.5 billion in loans and grants to rural areas in 1975. The new mark reflects a number of changes in the operations and the program emphasis over the long and varied history of the agency. Prior to the early sixties the annual lending volume of the agency never exceeded $400 million and the bulk of its activity was directed at farmers unable to obtain financing from other lenders.

The recent history of the Farmers Home Administration (FmHA) has been influenced mainly by services implemented by Congressional concerns over rural development. As a result, the annual volume of funds extended by the FmHA has soared, paced largely by ventures in financing rural housing and community development. Well over one-half of the $33 billion extended by the FmHA throughout its history was extended in the past five years. Nearly one-half of the funds extended by the FmHA are now channeled through rural housing programs. Funds distributed through the expanded community facility programs and the relatively new business and industrial development program absorb an additional one-fifth, while the remaining one-third of the funds are channeled through the various programs available to farmers.

The surge in funds extended, as well as the shift in program emphasis, has been associated with significant changes in the lending practices and funding operations of the FmHA. Direct loans funded by Congressional appropriations were long the mainstay of the agency. But now, virtually all the funds extended by the FmHA are tied to insured or guaranteed loans which are funded by private investors and lenders. Moreover, the growing importance of guaranteed loans and the increased emphasis on participating in loans made by other lenders represent a marked departure from the long-held view that the FmHA was a secondary lender, serving only those unable to obtain credit elsewhere. In some programs the FmHA now serves as a primary lender. Because of the swiftness with which fundamental changes have occurred, the rapid expansion of the FmHA has gone largely unnoticed except by these closely associated with the organization.

A brief history

The history of the FmHA dates back to the Resettlement Administration (RA) established by President Franklin Roosevelt in 1935. RA programs were designed to resettle and rehabilitate a rural population racked by drought and depression. Relative to its lineage with FmHA, the RA is best known for instituting a supervised credit program that provided short-term loans and grants to low-income farmers—the forerunner to the FmHA's current farm operating loan program. The unique philosophy of the supervised credit program, and one that has served as the backbone of most FmHA programs, was that (1) funds were directed toward low-income farmers unable to obtain credit elsewhere and (2) borrowers were pro-

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vided technical and supervisory assistance to help convert marginal farms into self-sufficient ones.

The success of the supervised credit program was a major factor behind the 1937 enactment of the Bankhead-Jones Farm Tenant Act. The act instituted a low-interest, supervised, 40-year farm ownership loan program, the precursor to the farm ownership program operated by the FmHA today.

The name of the Resettlement Administration was changed to the Farm Security Administration (FSA) in 1937, and in 1938 the FSA was placed under the jurisdiction of the U.S. Department of Agriculture. Few new programs were instituted by the FSA as the fading of the Depression and the advent of World War II stimulated economic recovery. In 1942, however, the FSA did assume full responsibility for the farm water facilities program, instituted in 1937 to provide loans for farm water systems in states par-

The major loan and grant programs

Farmer programs

Farm ownership loans—Insured or guaranteed loans for farmers lacking other sources of credit to buy, improve, or enlarge farms they operate. Statutory limits are $100,000 at 5 percent interest with up to 40 years for repayment. The FmHA will accept a second lien on real estate securing loans of other lenders if the total indebtedness against the real estate does not exceed $225,000.

Farm operating loans—Insured or guaranteed loans to assist farmers lacking other sources of financing to purchase feed, seed, fertilizer, livestock, machinery, or other factors of production. The statutory limit is $50,000 with up to seven years for repayment. The interest rate is fixed annually in accordance with rates paid on U.S. Treasury obligations. The rate for fiscal 1976 is 8¾ percent. Private lenders are encouraged to provide as much of the financing as possible.

Emergency loans—Insured or guaranteed loans to sustain ongoing operations and cover production losses inflicted by natural disasters. Repayment terms range up to 20 years. Rates on loans covering actual losses are established at 5 percent, while rates on loans to sustain ongoing operations change periodically in accordance with rates paid on Treasury borrowings. A special emergency livestock loan program that provides guaranteed loans to distressed livestock farmers is available until December 1976.

Other farmer programs—Insured or guaranteed loans to help farmers develop recreational and other non-agricultural income-producing enterprises and for improvement of soil and water resources; loans to nonprofit associations for irrigation and drainage systems and grazing ranges; loans to Indian tribal organizations to purchase privately owned land within reservation boundaries. Statutory maximum terms for all of these programs are 40 years for repayment at 5 percent interest.

Housing Programs

Individual home ownership—Insured loans to families with low or moderate income, including senior citizens, living in rural communities of up to 10,000 in population.* Repayment terms range up to 33 years. The interest rate, currently 9 percent, is adjusted periodically. Supplemental benefits, however, may reduce the interest rate to as low as 1 percent for low-income families. Direct loans of up to $5,000 for home repair are available to very low-income families for 20 years at 1 percent interest.

Rental housing—Insured loans to provide modernized rental housing for senior citizens and younger families of low to

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ticularly affected by drought. This was the forerunner of the many water-related programs administrated by the FmHA.

The Farmers Home Administration Act of 1946 reorganized the Farm Security Administration into the FmHA and authorized an "insured" farm ownership loan program. In the first three years of its existence the FmHA concentrated on providing supervised credit to farmers. In 1949 the Federal Housing Act authorized the FmHA to make housing loans to farmers and the Disaster Loan Act implemented special emergency loans for farmers that sustained losses from natural disasters.

The FmHA's array of services was expanded markedly during the first half of the sixties. The Consolidated Farmers Home Administration Act of 1961, among other things, raised loan limits for both the farm ownership and the farm operating loan programs and expanded coverage of the water facilities program to rural com-

of the Farmers Home Administration

moderate income in rural communities with populations of up to 10,000.* Repayments range up to 50 years for senior citizen housing, 40 years for others. The interest rate is adjusted periodically, with reduced rates for public, nonprofit and limited-profit developers of modern units priced within the means of low-income tenants.

Other housing programs—Two-year loans to nonprofit developers of improved rural homesite areas; loans and grants for development of adequate farm labor housing; grants to qualified organizations to help low-income families accomplish "self-help" homebuilding projects by performing much of their own construction.

Community Programs

Water and Waste Disposal Systems—Insured loans for organizations, nonprofit corporations, and public agencies in rural communities with populations of up to 10,000 that lack financing for the development, treatment, or distribution of water or the collection, treatment, or disposal of waste. Terms range up to 40 years for repayment at 5 percent interest. Grants can be added where necessary to prevent the debt repayment load from imposing excessive service rates on users.

Community facilities—Insured loans for any essential community facility or service—including fire protection, community halls, hospitals, nursing homes, medical clinics, libraries, schools, and recreation centers—provided by a public body or nonprofit organization. Loans are made for up to 40 years at 5 percent interest.

Business and Industry

Industrial development loans—Insured or guaranteed loans to public, private, or cooperative organizations and to individuals in communities with populations of up to 50,000 for purposes of financing operations, purchases, and development of business and industry. Repayment terms range up to 30 years. Interest rates for guaranteed loans are determined by the lender and the borrower. Interest rates for insured loans, currently 10¾ percent, are adjusted periodically in accordance with the cost of Treasury borrowings.

Rural development grants—Available to public bodies to facilitate development of private business enterprises, including the development, construction or acquisition of land, buildings, equipment, streets, and utility extensions.

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*The population limit was raised to 20,000 by Congress in 1974 but has not yet been implemented by the FmHA.

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munities with populations of up to 2,500. In addition, the rural housing loan program was broadened to cover non-farm rural residents and low-rent apartment projects for senior citizens.

During the latter part of the sixties, Congressional actions expanding the agency's services concentrated on rural housing and community facilities programs. The water facilities program was broadened to cover both water and waste disposal systems in communities with populations of up to 5,500. For rural housing the practice of direct loans was largely replaced by insured loans; coverage was expanded (in 1971) to communities with populations of up to 10,000; and a subsidized loan program permitting rates as low as 1 percent was instituted for some low-income families and for developers of low-priced rental housing.

Two important revisions in the farm ownership program occurred in the early seventies. The individual loan ceiling was raised from $60,000 to $100,000. In addition, the agency expanded cooperative efforts with other lenders by consenting to take a second lien on security mortgaged both for the FmHA and other lenders' loans. The latter action marked a more liberal interpretation of the restriction that limits FmHA loans to farmers unable to obtain credit from other lenders.

A major expansion in FmHA services was mandated by the Rural Development Act of 1972, an act that vested primary responsibility for all federal activities involving rural development in the Department of Agriculture. Among other things the act authorized the FmHA to guarantee loans made by commercial lenders and established a new program for financing business and industry in rural cities with populations of up to 50,000. The act also markedly expanded community facilities programs by abolishing some lending ceilings, raising grant authorizations, and broadening the types of community facilities eligible for FmHA financing. In the area of farmer programs the Rural Development Act raised the individual farm operating loan limit from $35,000 to $50,000 and authorized insured (as opposed to direct) farm operating loans.

Widespread damage caused by floods and hurricanes in 1972 induced Congress to liberalize the emergency disaster loan program. Interest rates were reduced to 1 percent and a "forgiveness clause" was attached to the first $5,000 borrowed to cover actual losses. The cost of the disaster loan program soared, however, and the liberalized features were suspended the following year. In 1974 widespread losses among livestock producers encouraged Congress to pass a special Emergency Livestock Credit Act which, as amended in 1975, authorized the FmHA to guarantee up to $1.5 billion in loans to livestock producers. The program is scheduled to end in December 1976. In 1974 Congress expanded the housing programs by permitting loans in rural communities with populations of up to 20,000 and authorizing loans on mobile homes and condominiums.

Structure and organization

The rapid expansion of the Farmers Home Administration into new program areas in recent years in part reflects its vast structure, which stretches from Washington D.C. to virtually every county in the United States. The implementation of Congressional programs for rural development has been markedly simplified by reliance on this established, decentralized network of FmHA offices.

The national office of the FmHA in Washington, D.C. is headed by a Presidentially appointed administrator who operates under the jurisdiction of the U.S. Department of Agriculture. The responsibilities of the national office revolve around the formulation and administra-

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FmHA loans and grants extended in district states in fiscal 1975

	Ill.	Ind.	Iowa	Mich.	Wis.	United States
	(million dollars)					
All farmer programs*	88	36	109	50	121	2,009
Operating loans	13	10	18	12	19	551
Ownership loans	12	10	15	7	15	352
Emergency disaster loans	59	13	44	28	84	735
Emergency livestock loans	4	2	31	2	4	353
All rural housing programs*	65	73	61	91	44	2,245
Individual owners	53	63	44	71	31	1,931
Rental housing	12	10	17	19	13	292
All community programs*	27	31	17	28	12	869
Water and waste systems						
Loans	13	15	10	14	5	470
Grants	4	4	4	5	4	177
Facilities	10	7	2	8	3	200
All business and industrial*	13	3	7	7	9	364
Loans	13	3	7	7	9	350
Grand total	**194**	**143**	**194**	**176**	**187**	**5,486**

*Totals include small amounts not listed separately.

tion of policies and procedures to implement federal statutes. In addition, administrators of the FmHA frequently advise Congress regarding the status of existing programs and the value of proposed programs.

The national office also provides a temporary allocation of the annual program ceilings among the various state offices. (The program ceilings, which are normally established as part of the Congressional appropriations bill, set upper limits on all loans and grants to be extended in a fiscal year.) Toward the end of a fiscal year, unutilized allocations are pooled so states that face particularly heavy loan demands have access to a greater volume of allocations.

The Secretary of Agriculture appoints state directors who are responsible for implementing the policies and procedures established at the national office. There are presently 42 such directors handling FmHA matters in the United States and its territories. Several district directors within each state are part of the state director's staff and serve as liasons between the state office and the county offices.

The FmHA maintains 1,780 county offices representing 3,066 rural counties. For most programs the county office serves as the main contact between the federal agency and borrowers. The county offices are responsible for determining the eligibility of borrowers as well as servicing and documenting loans. The county office is also responsible for approving loans for most of the farm programs and the rural housing programs. Large loan requests, more typical in the business and industrial development program or one of the various community facilities programs, are normally approved at the state level.

Funding and lending practices

For many years direct loans and grants were the avenues used to channel FmHA funds into rural areas, and both required annual appropriations of government funds. Although direct loans and grants are still utilized by the agency—particularly in rural housing and community facilities programs—their relative importance has diminished considerably. Today, the bulk of FmHA lending is handled through "insured loans" and "guaranteed loans." In general, insured loans are those made, funded, and serviced by the FmHA. Guaranteed loans are ones made, funded, and serviced by private lenders with an FmHA guarantee that the

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lender will not lose a stated percentage of the loan, usually 90 percent. Terms on insured loans are defined by statutory guidelines, while terms on guaranteed loans are generally negotiated between the borrower and the private lender.

Three revolving funds support FmHA insured and direct loans, as well as its liabilities stemming from the guarantees of other lenders' loans. *The Agricultural Credit Insurance Fund*, established in the mid-forties, is the oldest and serves all farmer programs as well as some minor areas of the community facilities programs. *The Rural Housing Insurance Fund* was established in 1965 in conjunction with the inauguration of insured rural housing loans. *The Rural Development Insurance Fund* was established in 1972 to cover lending activities related to the community facilities programs and the business and industrial development program.

The three revolving funds are based on government capital. But for ongoing operations, annual government appropriations are limited largely to the amounts necessary to cover losses in the revolving funds. The bulk of the funds used to finance ongoing operations are derived from principle and interest payments on loans held by the FmHA and from the sale of obligations to investors, such as individuals, banks, trust and pension funds. Since the development of the Federal Financing Bank in 1974, all investor obligations of the FmHA have been sold to the Federal Financing Bank, which uses these and other agency obligations as security for its own obligations which it, in turn, sells to investors.

Opportunities for banks

The operating guidelines of the Farmers Home Administration still state that farm ownership and farm operating loans are available only to farmers unable to secure credit elsewhere. But since the early seventies the FmHA has actively promoted its willingness to accept second liens on real estate mortgages and to supplement farm operating loans provided by other lenders. In fiscal 1975 banks and other lenders provided $371 million in loans to farmers under such participation arrangements, down somewhat from the fiscal 1974 total.

Guaranteed loans are perhaps the most promising area for joint opportunities between the FmHA and other lenders. Currently, the FmHA offers loan guarantees on farm ownership loans, farm operating loans, emergency disaster loans, emergency livestock loans, and business and industrial development loans. In general, loans guaranteed by the FmHA must be fully secured and, with the exception of business and industrial loans, are available only to borrowers who cannot obtain the needed financing without the guarantee. The lender is charged a fee for the FmHA's guarantee, which covers losses of up to 90 percent of the loan. Interest rates are either negotiated between the borrower and the lender or established by statutory provisions. Where statutory provisions hold rates below the lender's normal charge, however, the FmHA provides an interest subsidy.

Guaranteed loans were first authorized by the Rural Development Act of 1972, but were not implemented until fiscal 1974. Despite the recent innovation, the volume of guaranteed loans accounted for 14 percent of all loans and grants extended by the agency last year. Of the $763 million in guaranteed loans extended in fiscal 1975, nearly one-half was channeled through the business and industrial loan program, accounting for virtually all of the loans extended under this program. Other guaranteed loans were distributed through farmer programs with most going through the emergency livestock credit program.

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How useful are export promotion programs?

In international trade as in domestic trade the provision of credit is an important factor in facilitating transactions. Depending on the nature of the transaction and the type of goods being traded, such credit in the international sphere typically takes the form of open account credit provided by exporting firms or some form of short-term credit such as bank-issued letters of credit or bankers' acceptances. In the case of goods where the return is realized over a longer period of time (as, for example, capital goods), the credit usually takes the form of intermediate- or long-term loans.

Most trade-financing credits in the free world economies are provided by the private sector, either directly by the seller of the goods or indirectly by financial institutions specializing in the provision of credit—primarily banks and insurance companies. However, a portion of the exports of virtually all countries is financed by credit provided by governments, usually through special agencies established for that purpose. The United States is no exception. Over the years the U.S. Government has established or supported several institutions designed to facilitate U.S. export trade by direct or indirect credit assistance. This article surveys some of these programs and evaluates their contribution to the national welfare.

The Export-Import Bank

The Export-Import Bank of the United States, or the "Eximbank" as it is usually called, was established in 1934 by executive order. It was continued as an agency of the U.S. Government by Acts of Congress in 1935, 1937, 1939, and 1940 and was made an independent agency of the government by the Export-Import Act of 1945. This act has been amended on seven occasions since 1945, each extending the bank's authorization. The most recent amendment extends the bank's authorization through June 30, 1978.

Until 1971 the operation of the bank was funded through the federal budget. The Export Expansion Finance Act of 1971 not only removed the bank's receipts and disbursements from the purview of the federal budget but also substantially increased the bank's lending authority. The purpose of the bank as authorized by Congress is "to provide guarantees, insurance, and extensions of credit at rates and on terms and other conditions which are competitive with the government-supported rates and terms and other conditions available for the financing of exports from the principal countries whose exporters compete with United States exporters."[1]

According to the enabling act, the Eximbank is directed to supplement private financing of exports but to refrain from competing with private capital sources and to assist in financing export transactions for which financing otherwise would not be available but which, in the bank's judgment, hold a reasonable promise of repayment. The bank is authorized to extend aid through medium- to long-term loans, the purchase or discount of existing export loans, export loan guarantees, and insurance against loan default.

[1]U.S. Congress, Public Law 93-646 Section 3 (6)(L)(A) Amendments to the Export-Import Act of 1945, 93rd Congress H.R. 15977, January 4, 1975.

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The Direct Loan Program—Transactions qualifying for this program usually involve multimillion dollar contracts requiring medium- to long-term financing. For a loan to warrant Eximbank direct loan participation, it must be established to the bank's satisfaction that alternate credit institutions (domestic or foreign) are unable or unwilling to assume the full financing risk or that U.S. financial institutions cannot compete with foreign financing arrangements covering a non-U.S. product. In practice, a U.S. financial institution applies for Eximbank "participation" in the export loan. If participation is deemed appropriate, the Eximbank determines the extent of its involvement, which over the past several years has ranged from 30 to 55 percent of the contract value. Typically, with such an arrangement the foreign buyer provides a 10 percent downpayment, and U.S. financial institutions provide the balance.

As of early December 1975 the Eximbank interest rate on participations ranged from 8.25 percent for loans with maturities of under six years to 9.5 percent for loans of more than 14 years duration. (Maturities are calculated from the date of authorization.) Under unusual conditions lower interest rates may be charged to meet foreign interest rate competition. The commercial market rate and the lower Eximbank rate taken together result in a "blend" rate that is lower than commercial bank rates, thus providing the U.S. exporter with a relatively strong bargaining position with respect to foreign competition. Under current Eximbank policy the lowest "blend" rate that will be supported to meet foreign competition is 7.5 percent—a floor rate on which major industrial countries reached tentative agreement.[2]

The Loan Guarantee Program—Under this program the full amount of the export loan is provided by a commercial bank, and the commercial bank, in turn, applies to the Eximbank to guarantee the loan against loss due to political or credit risks. Currently, the Eximbank will guarantee as much as 85 percent of the loan, but the range of guarantee coverage varies from time to time. Typically, to assure guarantee coverage, the Eximbank requires: that the importer supply a 10 percent cash downpayment, that the U.S. exporter carry a portion of the credit risk, and that the U.S. bank carry some prescribed share of the risk during the early portion of the loan.

The Discount Loan Facility—This facility came into being in 1966 and was restructured in 1969 and again in 1971. Its purpose is to encourage U.S. banks to provide financing for exports during periods of tight money. Banks also may obtain advance commitments from the Eximbank for loans to be discounted over the year, thus assuring that the loans will not impinge on the commercial bank's liquidity position. Banks that utilize this facility are usually medium-sized regional institutions that find it an effective way to serve customers in the export business without tying up their liquidity position.

The Cooperative Financing Facility—Aimed at small- to medium-sized export transactions—in essence, those purchases and loans most easily evaluated by local foreign financial institutions—this facility assists foreign banks that are financing purchases of U.S. exports. The Cooperative Financing Facility (CFF) will lend up to 50 percent of the value of the loan, and the foreign bank, in turn, lends the full amount to the importing firm. The individual foreign in-

[2]In November 1975 the major industrial countries agreed to a system of "information sharing" on interest rates charged for subsidized export credits. The shared information applies to interest rates the eximbanks of various nations propose to offer on specific export deals under negotiation. It is reasoned that this information will allow competing countries to offer similar rates and thereby reduce competition based on export credit subsidies—assuming competitive interest rate reductions do not take place.

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stitutions accept full credit risk. The CFF was established in 1970 and its importance has increased steadily. In 1974 CFF funds went to 350 banks in 56 countries.

Other supportive organizations—In addition to the efforts to promote exports through direct involvement in the provision of trade credit, the U.S. Government has been involved in indirect support through its participation in essentially private institutional arrangements aimed at supplying export credits.

The Private Export Funding Corporation (PEFCO) was established in 1971 as a private institution jointly owned by 55 commercial banks, seven industrial companies, and an investment banking firm. All export loans financed by PEFCO are unconditionally guaranteed by the Eximbank. In addition, the Eximbank guarantees PEFCO's debt obligations. These guarantees, plus the equity capital in PEFCO and the lines of credit provided by the associated commercial banks and the Eximbank, form the base for PEFCO's ability to borrow in the money markets at comparatively low interest rates and to make short- to medium-term low-rate loans.

The Foreign Export Credit Insurance Association (FCIA) is an association of insurance companies that provides credit insurance for small- and medium-sized firms. Situations insured by FCIA include credit risk due to default or insolvency on the part of the importer. Political risks (actions taken by the importer's government that prevent payment for the shipment) associated with FCIA credit insurance are covered by the Eximbank.

The Commodity Credit Corporation

The Commodity Credit Corporation (CCC) was established in 1933 and operated in close affiliation with the Reconstruction Finance Corporation. It was made a permanently chartered agency of the U.S. Government in 1948. Since its inception its nominal purpose has been to stabilize and support agricultural commodity prices and farm incomes. But during the years of its existence the CCC has been used extensively as a tool of export promotion. The assistance it lends in promoting U.S. agricultural exports is designed to complement domestic agricultural policy objectives. Over a substantial portion of the life of the CCC domestic agricultural production greatly exceeded the domestic capacity to utilize the products at prices considered by policymakers to provide an adequate return to farmers. The CCC stood ready to purchase selected agricultural products based on a schedule of minimum prices to support domestic farm prices. In the process the CCC accumulated stocks of farm commodities, and foreign markets provided an ideal outlet. The Commodity Credit Corporation's involvement in extensions of export credit promotes agricultural exports in two ways: advantageous interest rates and, probably more importantly, credit terms that exceed the expected life of the product. In practice the export-promoting functions of the Commodity Credit Corporation have been traditionally executed through three main programs, two of which have an export-financing component.

The Export Credit Sales Program—This program provides financing for commercial sales of agricultural exports. The credits typically are medium-term loans of up to three years in duration. Interest rates are tied to U.S. Treasury borrowing costs but also take into account the level of the commercial bank's prime rate and the Federal Reserve discount rate, as well as the lending rates of major foreign competitors.

Grants-in-aid—The CCC provides funds to foreign governments and selected foreign private traders to purchase agricultural commodities under Title I of

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Public Law 480 (the Agricultural Trade, Development, and Assistance Act of 1954, as amended). Unlike exports financed under other CCC programs, these exports typically fall into the economic aid category. The funds supplied by the CCC are reimbursed by Congressional appropriations rather than borrowed from the Treasury or the money markets. Repayments of some portion of these funds may be made in foreign currency.

The Commodity Export Program—Under this program the CCC provides direct subsidy payments or "payments in kind" to exporters of certain agricultural commodities shipped from stockpiles. The CCC also has been authorized to sell commodities from stocks acquired in domestic price support operations to private U.S. exporting firms. This program was particularly active during the period when domestic agricultural prices were generally higher than world prices. The Commodity Export Program subsidies provided the differential between the world market price and the U.S. price. Since the termination of "export differentials" for wheat in 1973 the program has not covered a large volume of commodities.

Evaluating government export promotion programs

In assessing the efficacy of government credit programs to promote exports and to place the issues in focus, it is perhaps best to consider the programs in the framework of a "cost-benefit" type analysis. It must be understood that all of the programs discussed have one thing in common: they employ forms of subsidies that imply a cost to the nation.

In some programs, such as the Commodity Export Program of the CCC, the cost is direct and obvious: the government uses public funds to make up the difference between the purchase price and the selling price of particular commodities. In other programs the subsidy (and its costs to the taxpayer) may be more subtle. For example, when the government finances an export loan at an interest rate lower than the market rate, two things occur: one, the market price of the commodity (to the extent that the credit terms for which the goods are sold are an integral part of the "total price" of the purchase) is reduced from what it would have been under a market-determined solution, and two, the cost inflicted on the taxpayers and society in general can be either direct (as a result of the government borrowing at higher interest rates than those realized when it lends) or indirect (as when government borrowing siphons off funds from other uses causing the cost of credit to increase to all other borrowers). The costs inflicted upon society can be justified if, on balance, the benefits of government intervention increase the well-being and welfare of society as a whole.

The theory...

In a market economy the exchange of goods and services is carried on in response to various incentives present in the market. On the demand side the incentives include the purchasing power of the buyer, the buyer's set of preferences among various available alternatives, and the price of the contemplated purchase relative to complementary or substitute alternatives. On the supply side the various costs incurred in the process of production determine what the producer is willing to produce at various prices. Through the "give and take" of the marketplace, demand and supply are brought into an "equilibrium" characterized by maximum satisfaction of the consumers under given constraints and by "optimal" allocation of resources among various uses in the productive processes (optimal in the sense that consumer preferences are met). It is these preferences that function as the ul-

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timate arbiters of what shall be produced.

Under most circumstances when a subsidy in whatever form is introduced, the "optimality" of the market solution is disturbed. A subsidy lowers the price of a product and leads to a rearrangement of priorities. Consumers respond by demanding more of that good and producers respond by increasing production. More resources are devoted to the production of exported goods and less to the production of other goods. To the extent that the subsidized commodity is sold exclusively abroad, the lower price benefits only foreigners. Consumers in the exporting country suffer because, in the aggregate, lesser amounts of other commodities are available to them.

A national policy of export promotion may have a net positive effect, as when resources lie idle and when, in effect, a subsidy makes it possible for producers to lower prices thereby increasing demand and making it possible to employ these resources. Under such circumstances availability of goods domestically is *not* reduced by export production, and the added employment may be viewed as a net increase in society's welfare. However, in principle, such policies amount to the "export of unemployment" as the country's production displaces production abroad. Typically, such policies have been resisted by other countries who usually retaliate by adopting similar policies negating, in effect, the net benefits gained by the initiator.

Under the system of floating exchange rates now widely used, an additional and commonly overlooked complication is introduced that makes governmental efforts to increase exports through subsidies self-defeating. As exports increase, with other things equal, the supply of the exporting country's currency on world exchange markets is reduced since more of that country's currency is needed to pay for its exports. This inevitably forces up the price of that currency in terms of other currencies. As the price of the currency rises, the prices for all goods exported by that country rise apace (in terms of foreign currencies) and demand declines. The result: exports, particularly of nonsubsidized commodities, are reduced, leaving the exporting country in essentially the same position in respect to its trade balance and employment as before—but poorer by the amount it has expended on the subsidy.

In summary, the preponderance of evidence gleaned from basic precepts of economic theory suggests that an export subsidy, while in some instances beneficial to a particular segment of a country's economy, is, on balance, detrimental to society as a whole.

...and the practice

In recent years the U.S. export promotion programs have attracted much attention. The praise typically focuses on the contributions these programs have made in expanding the country's exports; the criticism essentially derives from the alleged distortions in the markets that they cause. In analyzing and evaluating the performance of the programs discussed in this article against the backdrop of theoretical precepts, it may be useful to distinguish among various phases of their existence.

Most of the programs date to the Depression of the thirties. Given the great underutilization of resources that characterized that period, it appeared to make eminent sense for the government to use its resouces in efforts to revive the economy by providing stimulation to domestic production through stimulation of exports. The facts, however, suggest that rather than contributing to the recovery, such measures contributed to deepening the Depression by precipitating worldwide retaliation, which led ultimately to a severe retraction of world trade.

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Thus, the contributions of these programs to the national welfare over that period remain doubtful.

In the postwar period the programs were used effectively to carry out the grand design of foreign aid to the war-devastated world. The humanitarian and political objectives achieved by these programs provided, at least in principle, a conceptual offset to their "costs."

With the rebuilding of the world economy largely completed by the late fifties, and with foreign aid largely phased out, the programs tended to lose their usefulness. However, by the mid-sixties a new, conceptually persuasive argument favoring their continuance began to emerge. At that time the trading world functioned on the basis of a system of fixed exchange rates that, with minor modifications, were established in the late forties. The profound changes that had actually taken place in the relative economic strengths and positions of individual countries had failed to be reflected in the relative exchange rate structure of national currencies. For various reasons governments were reluctant to adjust the exchange rates to reflect the new realities. By the middle sixties the U.S. dollar had become increasingly overvalued relative to currencies of such rapidly expanding economies as the European Common Market and Japan. The ultimate results of the dollar overvaluation were a rapid erosion of the competitiveness of U.S. goods on the world markets and a rapid shrinking of the U.S. trade balance.

Given the key position of the U.S. dollar in the post-World War II monetary system, it was felt that the overvaluation (and the growing imbalance) could not be corrected by a unilateral U.S. devaluation that would bring the exchange rate of the dollar into better alignment with the currencies of U.S. trading partners. Under these circumstances export credit subsidies provided a means for a partial adjustment by reducing the effective price of U.S. exports. The implicit "cost" of subsidies in this particular context may be viewed as representing a "payment" against what amounted to the United States living "beyond its means" due to the misalignment of the exchange rates. The "distortions" implicit in the programs were not, under these circumstances, distortions of an optimal situation but rather corrections (however imperfect) of the distortions and misallocations that existed in the world economy as a result of the exchange rate disequilibrium.

Obviously, the programs were inadequate to correct the growing disparity. The disequilibrium deepened until, in August 1971, the conditions became ripe for a more fundamental and efficient adjustment—the devaluation of the dollar. The devaluation, and later the adoption of floating exchange rates among major currencies in 1973, provided a means of adjusting to divergencies between individual economies—and greatly undermined the major rationale for continuing the export promotion programs that existed under a regime of misaligned, fixed exchange rates. Thus, in the present setting the broad contribution of the export promotion programs to the national welfare is questionable.

Even apart from the broad principles involved, there are some obvious inconsistencies within the government's export credit programs that appear to warrant a reevaluation. For example, the Eximbank charter makes the bank responsible for providing credit at below-market rates to encourage and promote exports and at the same time directs the bank not to compete with commercial banks.

Another area that calls for close scrutiny is the Eximbank practice of making loans to finance U.S. exports for which there is no effective foreign-made substitute product and no shortage of financing. A prime example is the longstanding

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practice of financing commercial aircraft purchases by foreign government-owned airlines. Given the lack of substitutes, most likely the aircraft would be sold, Eximbank or not. The question then is where should the financing originate?—in the United States or in some foreign country? The current interpretation of the Eximbank charter apparently is to assist U.S. financial institutions to compete with foreign financial institutions for the extension of these credits—certainly a step beyond what could be considered simply the promotion of U.S. exports.

It would be grossly unfair to say that all export subsidy programs should be abolished. Rather, the "passing away" of a major rationale for programs as they presently exist suggests that the government can no longer accept the proposition that the programs are unequivocally beneficial. The government should scrutinize and evaluate the programs on their merits to determine how they match the realities of a changing world.

Jack L. Hervey

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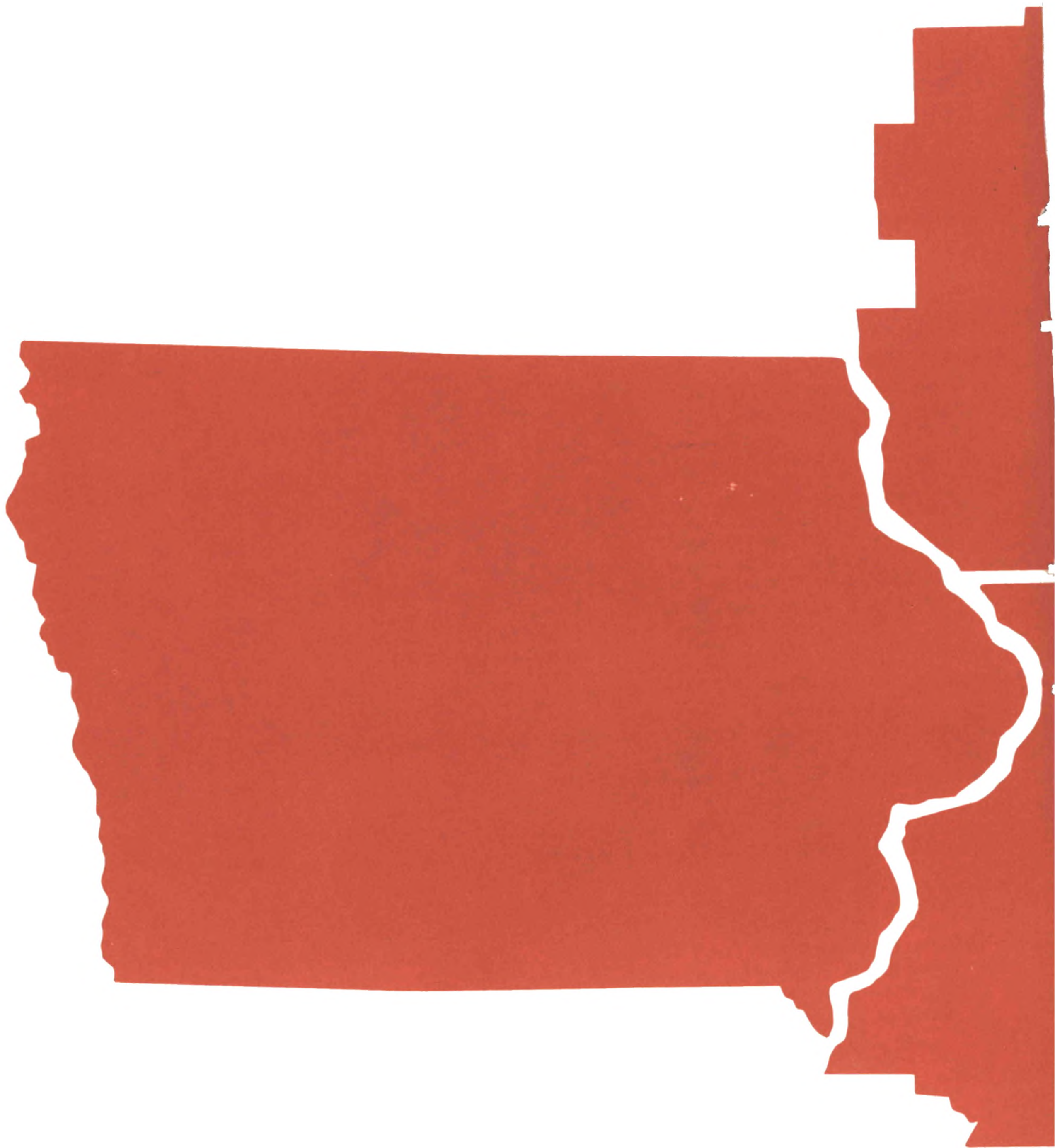

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