

# Asia's Financial Crisis: California's Agriculture has Weathered Similar Storms

by Colin Carter

Recently, the Asian financial crisis and El Niño have been competing for newspaper headlines. The contest is over which phenomenon is having the greatest impact on California agriculture. The headlines have been eye-catching but pessimistic. It is very unusual for economic issues to receive as much public attention as the weather. I am not an expert on the weather or El Niño, so I will not comment any further on that topic. However, I do believe the press has largely overstated the situation with regard to Asia's economic problems and the implications for California agriculture. Often the media focuses on the exceptional pessimistic cases (such as the fall in Korean imports of cowhides) and overlooks less exciting generalizations, such as "export business as usual" for many products. However, I take the constructive view that the press has laid out the worst-case scenario due to Asia's woes and this is informative because we can compare it against the best-case scenario. In this article, I take a balanced view of the most probable impact of the so-called Asian crisis on California agriculture and I argue that the impact will be significant for only some commodities, insignificant for most and generally short-lived.

International trade is indeed important to California agriculture because 25% of California's agricultural production is exported abroad. Of these foreign exports, over 70% are sold into the Asian-Pacific region. For California, the top six export destinations are Japan, Canada, European Union (EU), South Korea, Hong Kong (with considerable smuggling into China), and Mexico - all in the Asian-Pacific region, except for the EU. Within Asia, Japan is by far the largest market, accounting for about 27% of California's agricultural exports. The second largest market in the region is South Korea (9%), followed by Hong Kong (6%) (without adjusting for smuggling into China).

In the 1990s, growing demand and freer trade in several Asian economies stimulated growth of California's agricultural exports. Has the import demand bubble now burst, given Asia's current economic problems? The financial crisis in Asia is expected to harm their growth prospects due to a mix of overvalued currencies, large current account deficits, and unfavorable bank loans. Weaker Asian currencies will discourage U.S. exports but encourage U.S. imports from Asia, to

the benefit of U.S. consumers - a fact often overlooked.

With the economic crisis in Asia, the margin of uncertainty over trade prospects has clearly increased - but just how much alarm is justified? The five countries most affected by the crisis include Thailand, the Philippines, Malaysia, Indonesia, and South Korea. Of these countries, only South Korea is a significant importer of California food. Indonesia (3% share) is much less important to California agriculture, and the other three countries are insignificant importers from California's perspective.

I would be quick to agree that some concern over the poor health of the Asian economies is warranted because exports into that region have been growing quite rapidly in the past five years and this growth may well slow down in the short-term. California tends to export several high-valued agricultural commodities (such as fruits, horticultural products, and processed foods) and there is reason to believe that the Asian demand for these commodities will be hardest hit. Of course, California also exports bulk commodities such as rice and cotton, and that trade should not suffer too greatly.

The crisis has affected some Asian economies more than others. For instance, China's economy has been little affected and growth remains above 8% per year. In addition, China's foreign reserves stand at about \$136 billion, up from \$97 billion a year ago, so there is little pressure to devalue. South Korea is at the other end of the spectrum, and its currency (the won) has fallen over 90% in the past year (see Table 1). At the same time, the depreciation has been much lower for the Japanese Yen

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Table 1. Percent change in key Asian currencies over the past year (Mar.'97 - Mar.'98)

<u>Country</u>	<u>% of CA.'s Ag.Exports</u>	<u>% change in Currency</u>
China	3-5	0
Hong Kong	3-5	0
Japan	27	-6
South Korea	9	-91
Taiwan	4	-20
Thailand	1	-70

**Table 2. Summary Economic Statistics for Key California Markets**

	Real GDP Growth Rate %	U.S. Agric. Exports \$Billions	Exchange Rate Foreign Currency/ \$ U.S.
<b>Japan</b>			
1990	5.4	8.06	134.4
1991	3.8	7.73	125.2
1992	1.0	8.44	124.7
1993	0.3	8.74	111.8
1994	0.6	9.46	99.7
1995	1.4	11.17	102.8
1996	3.5	11.70	116.0
<b>South Korea</b>			
1990	9.5	2.64	716.4
1991	9.1	2.10	760.8
1992	5.1	2.22	788.4
1993	5.5	1.93	808.1
1994	8.8	2.33	788.7
1995	8.9	3.75	774.7
1996	7.1	3.87	844.2
<b>Mexico</b>			
1990	5.7	2.55	2.95
1991	4.2	3.00	3.07
1992	3.6	3.79	3.11
1993	1.9	3.60	3.11
1994	4.5	4.59	5.33
1995	-6.2	3.54	7.64
1996	5.1	5.45	7.85
<b>Canada</b>			
1990	-0.2	4.20	1.16
1991	-1.8	4.55	1.15
1992	0.8	4.90	1.27
1993	2.2	5.27	1.32
1994	4.1	5.58	1.40
1995	2.3	5.81	1.36
1996	1.5	6.15	1.37

Note: data are on a calendar year basis.  
Sources: USDA, International Monetary Fund

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(6%), California's biggest market.

In agriculture, fluctuating currencies impact export prices more than export volume. This is important to keep in mind because the most apparent impact of the Asian crisis may show up in export prices received by Californians.

This recent economic downturn in Asia is not exactly unprecedented in the history of California's agricultural trade. Fluctuating currencies and stagnant income growth have affected California agriculture in the past. California agriculture experienced first hand the Latin American debt crisis in the early 1980s. At

that time, the U.S. dollar also appreciated rapidly and both events led to reduced agricultural exports. Table 2 illustrates that from 1993 to 1995, the Mexican Peso fell from 3.1 Peso per dollar to 7.6 Peso per dollar (a 145% fall). Doom and gloom was predicted, and in fact U.S. agricultural exports to Mexico subsequently fell in the short-term from \$4.6 billion in 1994 to \$3.5 billion in 1995. Despite severe criticism, the U.S. government offered Mexico a \$50 billion package of loans to facilitate economic recovery. The Mexican "crisis" was truly short-lived and U.S. agricultural exports recovered quickly to \$5.4 billion in 1996 (see Table 2) approximately 20% higher than before the crisis began.

The U.S. Department of Agriculture has forecast a slowdown in U.S. farm exports to Asian countries this fiscal year (1997-98). The USDA forecasts exports to those countries at over \$22 billion, reflecting a downward adjustment ranging from \$500-million to \$1.5-billion due to the financial crisis - a 2 to 6% adjustment. This type of adjustment is possible, but the lower end (i.e., \$500 million) is most plausible.

The data in Table 2 suggest there are some important lessons to be learned from past experiences with California's most important trading partners. First, the Mexican recovery was quite rapid after the 1994 financial fiasco, often described as a V-shaped recovery. Second, the data in Table 2 for Japan show income growth was almost stagnant from 1992 to 1995, growing only about 1% per year, on average. Despite this slow growth, U.S. agricultural exports to Japan expanded from \$8.4 billion in 1992 to \$11.1 billion in 1995, a 32% increase in just three years. Third, the Canadian dollar fell by about 18% from 1990 to 1996 (from 1.16 \$Cdn/\$U.S. to 1.37 \$Cdn/\$U.S.), making imports into Canada from the U.S. more expensive. Despite this adverse move in the currency from a U.S. perspective, U.S. agricultural exports to Canada expanded by 46%. These data suggest the impact of fluctuating foreign incomes and currencies on agricultural export growth are easily overstated.

In conclusion, some believe that Asia's economic problems will dramatically cut California's agricultural exports. I believe the situation will be much less traumatic and temporary. The Asian countries most affected by the financial crisis (Thailand, the Philippines, Malaysia, and Indonesia) are not very important importers from California's perspective. Japan, Canada, and Mexico combined account for one-half of California's agricultural exports, and sales to those countries have continued to grow despite bouts of unstable currencies and periods of stagnant income growth.

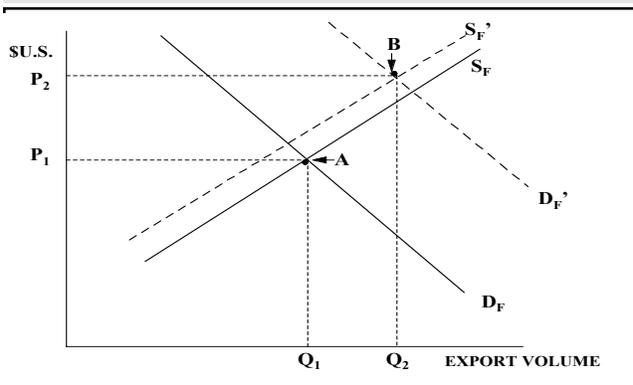
## How Do Exchange Rates Affect California Agriculture?

**A** swing in the value of the U.S. dollar vis-a-vis foreign currencies is one of the most important factors determining the economic environment for California agriculture. Just like the price of any commodity or asset, demand and supply establish the exchange rate. Exchange rates are important determinants of both trade volumes and prices.

For instance, we can think of the exchange rate between the Japanese yen and the dollar as being equal to the number of yen required to purchase one dollar. Suppose the yen/\$ exchange rate moves from 120 yen per dollar to 100 yen per dollar. In this case the yen has appreciated, since an appreciation refers to a decline in the domestic price of a foreign currency. At the same time, the U.S. dollar has depreciated relative to the yen, since a depreciation refers to an increase in the domestic price of the foreign currency.

The international market for California agricultural exports is demonstrated in the accompanying graph. It shows the demand ( $D_F$ ) and supply ( $S_F$ ) of California's agricultural exports. An appreciation of the foreign importer's currency is shown as a rightward shift in the demand curve, which shifts from  $D_F$  to  $D_F'$ . Due to the foreign currency's appreciation, the importer can now purchase more U.S. goods than before at any price level, measured in \$U.S. There may also be a small leftward shift in  $S_F$  if some of the inputs in California agriculture are imported from abroad. The supply and demand equilibrium shifts from point A to point B in the representative graph.

The upshot is that the export price in U.S. dollars rises and the volume and price impacts depend on the shape of the supply and demand curve and the extent of the shifts in the supply and demand curves. If instead the foreign currency depreciated, the process is reversed and the impact would be represented as a movement from Point B to Point A. In this case, California's export volume and price would decline.



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## A Time to Act

by Desmond Jolly

**I** was appointed by Secretary of Agriculture Glickman to the National Commission on Small Farms. *Time to Act*, the report of the National Commission on Small Farms was released in January, 1998. The report is the culmination of the commission's work based on several months of hearings and deliberations on the status of small farms in the U.S. *A Time to Act* makes recommendations to USDA, its land grant research and outreach partners, as well as to private agencies and institutions with respect to the adoption and implementation of policies, programs and practices that can contribute to the maintenance of a healthy diversity in production agriculture into the next century.

The report makes over 100 recommendations and references not only the economic prospects for, and contributions of, small farms, but also notes the several types of public-interest values that derive from a structurally diversified ownership and operation of production in the agricultural sector. These include: stewardship of natural resources; contributing to the social and economic vibrancy of rural communities, promoting positive links between consumers and farmers, and providing entry into opportunities for entrepreneurship and self-employment free enterprise in the historical sense.

Principal findings include a serious level of erosion in the competitiveness of markets, particularly in inputs and processor/packer systems. The commission notes as well that many intervention programs are not, in effect, size neutral, even though their conceptual design makes this assumption.

*A Time to Act* defines small farms for purposes of setting the boundaries for its agenda. The commission's recommendations emanate from its various committees which focused on credit and finance, marketing, research and extension, and environmental issues, and its recommendations embrace these areas, although the format is somewhat different. I chaired the committee on research and extension and served as Vice Chair of the Commission. The report advocates more vigorous enforcement of antitrust laws and promotion of marketing alternatives. It strongly encourages USDA to revisit its mission, purpose, policies, programs and practices and proposes specific articulation of objectives with respect to research, extension, risk management, environmental programs, and program administration.

Desmond Jolly is an Extension Agricultural and Consumer Economist and Lecturer in Agricultural and Resource Economics, and Vice Chair of the National Commission on Small Farms. To obtain a copy of *A Time to Act* contact Dr. Jolly by phone at (530) 752-7774 or FAX (530) 752-7716.