

Drought-hit agriculture sector slows economic recovery

Agriculture is one of the economic sectors that have been less severely affected by the COVID-19 pandemic. Thus, it could be expected that it would have a stabilizing effect on economies with large agricultural sectors such as Moldova, where agriculture accounts for 11% of GDP. Unfortunately, a stabilizing effect could not be achieved due to a severe drought that hit the country in the first half of the year. The effects of this have become visible in Q3 2020, which includes the harvesting season and when output in agriculture dropped by 31%. The crops worst affected by this drought, corn, soybeans, sunflower, wheat and grapes, are among the most important agricultural exports. Considering that agricultural and food products make up 40% of Moldova's exports, this has a large impact on the economy as a whole. Based on the size of the agricultural sector and its predicted overall decline of 27% in 2020, we estimate that the drought would have a negative effect on GDP in the range of 2 to 3 percentage points. It is therefore clear that instead of finding stability in agriculture, Moldova suffered from a double shock in 2020 with COVID-19 and the drought.

Background

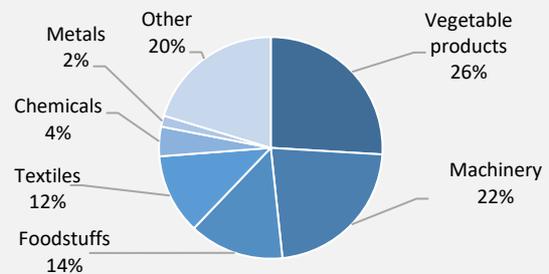
While the COVID-19 pandemic had negative effects on economies globally, agricultural sectors have been less affected. Apart from some difficulties in coordinating supply chains of agricultural products due to restrictions in international transport, in the first half of the year, no clear relationship between the pandemic and the supply and demand of agricultural commodities has been observed. Therefore, it could be expected that agriculture would have a stabilizing effect on the GDP of countries, where the sector accounts for a large part of the economy.

Moldova's agricultural sector

In Moldova, agriculture accounted for 11% of GDP in 2019, placing it among the three most important economic sectors behind retail trade and manufacturing. Within the sector, crop production makes up the largest share with 71%, while livestock production stands at 27%.

In addition, the agricultural sector is an important source of employment in Moldova. Rough estimates suggest that, when including informal employment, around 36% of the population works in this sector. In rural areas this share is even larger with up to 60%.

Export share according to product groups in 2019



Source: National Bureau of Statistics Moldova

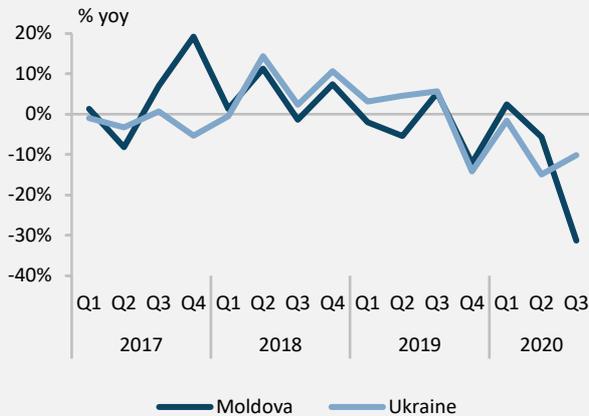
The sector also plays a significant role in the external trade structure of the country, where vegetable products (including cereals and oil seeds) and foodstuffs together account for 40% of exports. The most important vegetable products are cereals, fruit and sunflower. In the category of foodstuffs, wine accounts for the majority of exports. Livestock products are not exported at scale, with the exception of eggs for which export volumes have been growing by 11% p.a. from 2014 to 2018. In general, Moldova's agricultural exports have been growing at a faster rate than exports overall. This is particularly true for exports to the EU since the establishment of the free trade area ("DCFTA") in 2016. In 2019, 49% of Moldovan agricultural exports went to the EU, compared to 41% in 2014.

Drought causes shock in Moldova's agricultural sector

While the agricultural sector has been growing steadily, it is also vulnerable to external factors, in particular weather variability. This vulnerability was clearly revealed by the severe drought that hit the Moldovan agricultural sector in 2020. During Q3 2020, which includes the main harvest season, agricultural output was 31% lower than in the previous year.

The crop most severely affected by the drought was maize with a 71% decrease in output. Similarly, soybeans, sunflower and wheat outputs dropped by 46%. The output of grapes decreased by 37%. Overall, the agricultural sector is expected to decline by 27% in 2020. Thus, all major export crops experienced sharp declines.

Agricultural production indices in Moldova and Ukraine



Source: National Bureau of Statistics Moldova, State Statistics Service of Ukraine

Similar effects to those felt in Moldova have been observed in its neighbouring agricultural production regions. In Ukraine for example, agricultural output decreased by more than 40% in June, the worst affected month. However, the overall effect in Ukraine was less severe than in Moldova likely because only the southern region bordering Moldova was significantly affected.

Economic impact of agricultural sector losses in 2020

Given the size of Moldova’s agricultural sector relative to GDP and that of the decline in output, we estimate that agriculture contributes negatively to Moldova’s 2020 GDP growth with 2 to 3 percentage points. In addition to the economic impact of the COVID-19 crisis, this means that Moldova experienced a double shock. The loss in agricultural output suggests that expectations of an economic recovery from the COVID-19 shock in Q3 2020 may be disappointed. In addition, the drought could have some long-term effects on the economy, for example due to insolvencies in the sector, though the size of these is difficult to predict.

Challenges ahead

The impact of the drought illustrates the vulnerability of Moldova’s economy to external shocks in agriculture, including those related to weather risk. Formal risk management mechanisms such as agricultural insurance are not widely used in Moldova, with only around 2 to 3% of the total acreage being insured.

Furthermore, productivity in Moldova’s agricultural sector is low and investment (e.g. in irrigation equipment) in the sector is lacking. Despite its important role in the economy and its great need for investment, the agricultural sector accounted for less than 2% of FDI in 2018.

This lack of investment is connected to a number of structural problems in the sector, which impede growth. These include, firstly, regulatory provisions that in practice limit land leasing times to a maximum of 5 years, which is far below most investment timeframes. Secondly, the size of farms, which in many cases is too small to realize higher productivity. And lastly, a lack of investment in quality infrastructure that would enable improved access to EU markets. The implementation of structural reforms addressing these problems is necessary to foster investment and make agriculture in Moldova less vulnerable to weather shocks.

Author

Carolin Busch, busch@berlin-economics.com

Editor

Dr Ricardo Giucci

[Subscribe / unsubscribe newsletter](#)

German Economic Team

www.german-economic-team.com

Financed by the Federal Ministry for Economic Affairs and Energy, the German Economic Team (GET) advises the governments of Moldova, Georgia, Ukraine, Belarus and Uzbekistan on economic policy matters. Furthermore, GET covers specific topics in other countries, such as Armenia. Berlin Economic has been commissioned with the implementation of the consultancy.