Armenia: A Strange Crisis With an Optimistic Outcome

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Abstract

Armenia was one of the countries most severely hit by the global crisis of 2009. However, despite the sharp decline in GDP, the consequences for the larger economy were not as dramatic as initially expected. This was mainly due to the specific nature of the crisis which affected almost exclusively the construction sector, as well as the result of anti-crisis measures implemented by the Armenian government which managed to stabilize the situation through international loans. Moreover, it seems that the crisis of 2009 resulted in an overall structural adjustment of the country's economy which could have positive effects for the future.

2009: A Steep Decline in GDP

Armenia's economy suffered severely from the global economic crisis in 2009.[1] In the first quarter of 2009, GDP declined by 6.1% against the levels of the previous year. By July, GDP shrunk by an astounding 18.7%. Overall, Armenia's GDP level for 2009 was 14.4% below that of the previous year (see Figure 1 on p. 18). This was the second worst result in the world after Latvia. Moreover, this decline was even more astonishing because, as noted in an earlier article published in this journal,[2] this decline followed an eight year-period of impressive GDP growth, mostly at rates above 10% a year.

However, this decline did not, so far, result in a catastrophe for the overall economy, or in severe social consequences, as one could expect. This outcome had as much to do with the specific features of Armenia's economy as the anti-crisis measures adopted by the government led by Prime Minister Tigran Sargsyan.

The Pillar of Construction

In early in 2010, the National Statistical Commission of Armenia examined the different factors contributing to the catastrophic decline of GDP in 2009. The analysis revealed that most of the decline (11.4% of the 14.4%) was due to the crisis in a single sector of the economy: construction, which shrunk 36.4% against the level of the previous year. Had construction volumes in 2009 remained at the same level as in 2008, Armenia's GDP would have decreased by only 3%, including just 1% due to the fall in industry, where production fell by 7.8%. In fact, if not for these two sectors (construction and industry), Armenia's economy would have performed fairly well in 2009. Indeed, production of agriculture was almost stable (minus 0.1%) and services (without retail trade) showed a 1.3% growth during 2009.

Hence, the decline in construction was the principal factor driving the overall economic decline in Armenia. A more thorough analysis of the situation shows that in 2008, 71.1% of all construction works were funded by the population (the term used by the statistical service to designate funding from private means, including households). In the following year, the total allocations to construction fell drastically, as population funds for construction purposes fell to a third of their previous level (by 415 billion AMD (Armenian drams) or 1.12 billion USD). An increase in funding from other sources, such as the state budget, organizations, and international loans, only partially compensated for the sharp decline in private construction orders.

The decline in investments in construction correlated with the decline in the private remittances from abroad, especially from migrant workers, the majority of whom are living and working in Russia (80%). According to data from the Central Bank of Armenia, the inflow of these non-commercial funds sent via bank transaction amounted to 929 million USD in 2009, which was 33% (or 464 million USD) less than in the previous year. Yet strange as it may seem, the decrease in cash remittances were practically the only decrease in overall income for the population in Armenia. In fact, the average salaries in Armenia did not suffer in the year of the crisis; moreover, they rose, as shown below. It is very likely that the decrease of these remittances combined with psychological factors (insecurity) presented the principal trigger for the population to stop investing in construction, resulting in the sharp overall decline in this sector.

Hence, the principal impact of the global economic crisis on the Armenian economy in 2009 can be summarized as follows: The global crisis diminished for-

1 All the data and the comparisons are presented in this article for the periods from January to the month mentioned. For example, "GDP level in July" means the data for the period January–July. This is the usual method used by the National Statistical Commission of Armenia.

2 Haroutiun Khachatrian, "Armenia: How a Small Country Counters the Global Crisis," Caucasus Analytical Digest, No. 6, 21 May 2009, pp. 5–7.

eign remittances to an extent which was sufficient for the population to stop investing in construction, but they remained high enough to prevent any significant decrease in its living standards. A sensitive factor that demonstrates the unchanged living standard is the retail trade turnover, which grew by 1.1% during 2009.[3] In short, the huge drop in GDP, which would probably have meant a catastrophe for most other countries, did not result in any serious social problems for Armenia in 2009.[4]

At the same time, the nature of the Armenian crisis also serves to illustrate the country's highly unbalanced economic development. The rapid economic growth in 2001–2008 was caused mainly by strong growth in the construction sector, whose overall share in Armenian GDP grew from 13.9% in 2002 to 27% in 2008. Some economists warned of a "construction bubble," which was especially dangerous as it was highly dependent on the inflow of funds from abroad. When the decrease in that inflow resulted in the collapse of construction, its share in GDP almost halved in 2009 to 19%. In other words, the global economic crisis resulted in the burst of the "bubble" and the elimination of the construction sector as the "pillar" of Armenia's economic growth. Armenian Minister of Finance Tigran Davtyan mentioned in an interview in *Golos Armenii Daily* on 21 June 2010 that the economic decline last year was in a sense, a simple "technical recession," which, however, demonstrated with clarity that the diversification of the Armenian economy is an urgent task.

Other Spheres

As I argued in my earlier *Caucasus Analytical Digest* article, the global economic crisis would bring two principal challenges to the economy of Armenia: namely, a decrease in cash remittances to Armenia and a decrease in exports. As demonstrated above, almost the whole decline of the economy can be linked to the decline in money remittances from abroad. However, decline in exports also played a role. In 2009, exports saw a 34% drop compared to the previous year, while imports only marginally declined. The import/export ratio—which was already on the worrying level of 4.11—jumped further to 4.17, meaning an additional decrease in the net money inflow to the country. The government tried to help the main exporters; in particular, it extended loans to several copper mining companies.

Finally, an important factor during the crisis was the decrease in tax collections, which was a natural consequence of the decline in production and foreign trade turnover. This factor caused a drop in budgetary revenues to 74% of the planned amount during the crisis year. However, the government managed to escape reducing its expenditures significantly, as it took extensive loans abroad to fulfill its budgetary commitments. As a result, the state debt increased dramatically in 2009, from 17% of GDP in 2008 to 32% at the end of 2009 (or 2.72 billion USD in nominal terms). This is still a debt which can be serviced safely (for comparison, Greece's debt is 110% of GDP).

The Anti-Crisis Measures of the Government

The most important anti-crisis measure of the Armenian government was its decision to keep its expenditures at the level of the principal targets, set before the crisis began, thus keeping expenditures as high as possible, despite the subsequent decrease in the tax revenues. To finance this deficit spending, the government managed to obtain the following major international loans:

- From the International Monetary Fund (IMF): 800 million USD as anti-crisis support of which a total of 500 million USD was allocated in 2009.
- From Russia as a 500 million USD inter-state loan in June 2009 (at a rate of LIBOR+3 for 15 years).
- From the World Bank which had allocated 350 million USD out of a total of 760 million USD pledged aid for 2009–2012.
- From the Asian Development Bank which allocated a total of 80 million USD in aid. A larger loan of 500 million USD for construction of the North-South motorway connecting the Black Sea port Batumi with Iran will be allocated later.
- From the European Union which allocated 100 million USD for different assistance programs.

Thanks to the international funds, the Armenian government managed to fulfill almost all of the commitments defined in the initial version of the 2009 budget. As a result, the average salary in the country grew by 9.8% during the crisis, and all the pensions and other social payments were maintained at previous levels. In addition, the government of Tigran Sargsyan was also able to implement a number of measures aimed at stimulat-

3 Typically, the amount of remittances registered by the Central Bank is more than one third of the total retail trade turnover. In 2008, for example, these amounted to 1.4 billion USD and 3.4 billion USD respectively.

4 According to the estimates of the World Bank, the number of poor people in Armenia grew in 2009 from 25.6% of the population to 28.4%, or by 90,000 people. This was considered to be a fairly good result, as according to WB experts, with such a large GDP decline, the number of people living in poverty might have grown three times more than the level actually observed.

ing the different sectors of the economy and business. Among them were: initiating and continuing a number of infrastructure projects (in particular, in the zone of the 1988 earthquake) and the provision of funds to what the government considered to be promising business endeavors (a total of 14 billion AMD or 38 million USD were allocated to 44 projects). In particular, the government provided loan guarantees worth a total of 12 million USD to developers for finalizing unfinished construction projects. This action played a significant role in re-activating the construction sector, although it will take time for these measures to take effect. While the other sectors of the Armenian economy again showed rapid growth during the first quarter of 2010, the construction sector continued to shrink, with its apparent revival beginning only in April.

Conclusion

After the drastic fall of the economy during the crisis of 2009, the government was cautious about it future development. The draft budget for 2010 was based on a scenario of 1.5% GDP growth, which in late 2009 seemed cautiously optimistic. In the meanwhile, however, the Armenian economy showed strong growth of 8.8% during January–June 2010, thus much higher than expected. Most importantly, all major sectors of the economy contributed almost equally to this positive result. Thus the crisis to some extent corrected the highly unbalanced economic development of the previous growth period of 2002–2008, which was dominated by expansion in the construction sector. Thus, it looks as if the sharp economic decline or, as Armenia's Minister of Finance put it, the "technical recession," has resulted in serious structural changes in Armenia's economy. Whether this structural change is indeed sustainable and will have long-term positive effects for the country's economy is the subject for another analysis.

About the Author
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As If Nothing Happened?

How Azerbaijan's Economy Manages to Sail Through Stormy Weather

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Abstract

Since Azerbaijan seems to have coped with the impact of the global financial crisis far better than initially expected, it is worth taking a closer look at this country which seems far away from the stormy international fore of private sector and sovereign crises. Azerbaijan's financial sector had only limited exposure to international markets and the country's sovereign balance sheet is strong with a public debt ratio that is one of the lowest of all transition countries. However, the country depends heavily on its oil exports, so Azerbaijan felt the crisis directly through the high volatility of world oil prices. As a consequence, state authorities had to design effective policies to steer the economy through stormy weather.

Spring 2010: Rating Upgrade for Azerbaijan

First of all the good news. Fitch, one of the world's top three rating agencies, upgraded Azerbaijan's sovereign credit rating at the end of May 2009 from BB+ to BBB-.[1] Azerbaijan is thus now playing in the same league as Brazil, Peru, Bulgaria and India and even one category higher than Turkey, Iceland and Latvia. Why did Fitch upgrade Azerbaijan to investment grade?

The most recent financial crisis resulted, like financial crises before it, from excessive lending to the private sector. The key consequence was excessive household and banking sector borrowing throughout the advanced

1 A credit rating estimates the credit worthiness of a country. With a rating of BBB- Azerbaijan joins the ranks of investment-grade countries, meeting the minimum grade required by many institutional investors worldwide.